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Everyone's a Buyer . . .

WE ALL LIKE TO GO TO THE SHOPS AND SPEND NOW AND THEN, in fact every day most of us spend money one way or another. So we must be quite good at it.

It's the same at work. Most people spend their company's money from time to time. Nearly everyone likes to have a say in how money is spent on their behalf. In most organizations people at all levels are involved in one way or another with buying anything from paperclips to computers.

It's not difficult to pick up the phone to a company you deal with and put in an order, or to log on to a travel site on the Internet and book your own flights. Nowadays, it's not too much of an exaggeration to say that everyone's a buyer . . .

. . . but not an expert buyer

While most people like to spend their employer's cash, very often they are not actually achieving real value for money. This means that a lot of the money being spent by organizations of all kinds, from small businesses to local authorities to big companies, is wasted.

However, many companies employ specialists to spend money in an efficient, well-organized way. These purchasing professionals have the training, experience and market knowledge to make a better job of it. They are not necessarily the only ones who can do the purchasing and look after suppliers, but they are the experts. Their skills, ideally, will be highly sought-after. Everyone should want to involve them in their purchasing decisions because of the benefits they offer.

The hidden bonanza

There are big prizes to be won. Every organization wants to make more money, or at least to make sure that its limited resources are deployed effectively. The obvious way for a commercial organization to increase profitability is to raise prices, or sell more, or both. As Figure 1.1 illustrates, while fixed and variable costs will probably rise too, the profit margin is likely to grow faster.

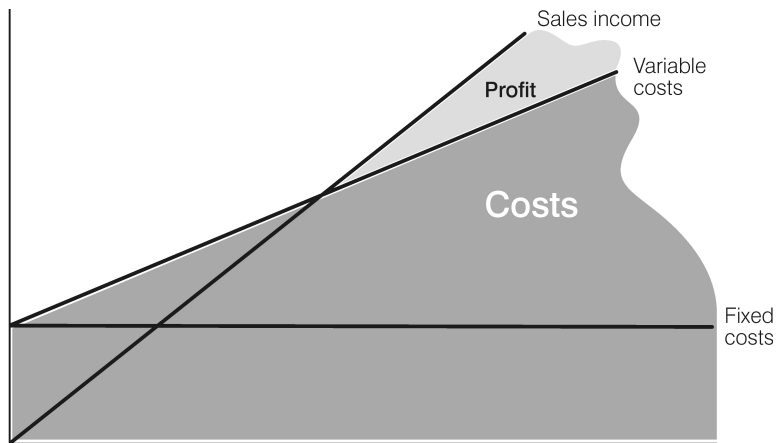


Figure 1.1

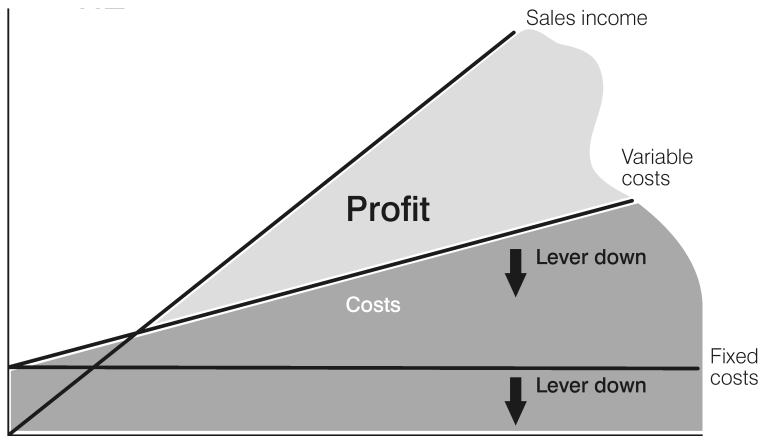


Figure 1.2

However, businesses are realizing that another way of becoming more profitable can be just as effective, if not more so – improving the purchasing operation. As Figure 1.2 shows, driving down variable and fixed costs through effective purchasing is just as effective in increasing profits as improving sales figures. And, as we shall see, concentrating on the purchasing function may also bring other benefits.

Undiscovered territory

Progress towards reforming purchasing functions is uneven. Many big, established companies have reformed their procurement, although often this merely reveals how much there is to do before they will become truly efficient. It's among small and medium-sized enterprises that purchasing remains largely unorganized and inefficient.

In the public sector, reform of purchasing is now high on the political agenda. The government has realized just how much can be saved

through streamlining buying by Whitehall departments, local authorities, the NHS, universities and other public bodies. At the time of writing, huge savings in the public sector were being discussed, based largely on greater centralization of buying operations and the adoption of e-procurement. The government has also made it clear that big increases in NHS spending must be effectively controlled to ensure value for money.

The surprising fact is that most organizations in the private, public and voluntary sectors simply don't know:

1. How much money they're spending with third-party suppliers.
2. Who's spending it.
3. What they're getting for their money.

This is partly because many people in business, often running large, well-known organizations, prefer to concentrate on more glamorous activities: sales, marketing and advertising, for example. Or finance, where the real decisions affecting the bottom line are made, or HR, where the huge amounts spent on the most important assets for any organization – its people – are controlled.

These functions attract enormous interest in the commercial and academic world. Go into any bookshop and look at the business section: there is likely to be a large selection of titles on marketing, selling and, quite likely, advertising. Look at the shelves filled with books on finance. And you won't be able to miss the huge numbers of 'inspirational' books by big-name management gurus offering recipes for instant commercial success, often focusing on sales and people management.

In contrast, there will be few books on purchasing and supply management. In most bookshops there are likely to be no more than a couple of academic and highly technical tomes. Some general management books will probably contain references to purchasing or certain subsections of the field, inventory management, for example.

Click on to the website of any major business school and search for 'marketing' or 'advertising' and there will be a plethora of courses specializing in these subjects. Now look for 'purchasing' or 'supply management' and you might discover a module or two buried in another more general course.

Examine the structure of contemporary companies and you will almost certainly find marketing and sales as separate functions, most likely with a representative at board level. Purchasing and supply management, though, are probably lurking within the manufacturing or finance department, or as part of central administration or some other branch of the company structure. Representation at board level is rare.

What is purchasing and supply management?

As a relatively young area of activity, many people are unclear what purchasing and supply management involves. This is almost certainly one reason for its relative obscurity on the business scene.

Roles within these functions vary enormously and the definitions are often somewhat hazy. But essentially, anyone who is involved in buying goods or services on behalf of their organization, arranging their delivery

and monitoring their cost and effectiveness, can fall within the definition of a purchasing or supply management professional.

This extends from the junior buyer in a small or medium-sized company right up to the procurement director of a major multinational. Purchasing and supply management professionals can be found in all sectors of industry and commerce, and in the public and voluntary sectors. Organizations ranging from small companies to major multinationals and from town halls to government departments are all quite likely to employ people responsible for buying goods and services.

It's estimated that in the UK there are perhaps 150 000 people working in purchasing and supply management roles. If the wider field of logistics is also included – people concerned with the movement of goods rather than specifically with their purchase – the number of professionals involved could be 250 000.

In the smallest enterprises, a separate role for a purchasing specialist may not have emerged: the managing director or finance director or one of the partners may do the buying. Or quite likely, everyone chips in as necessary.

But as with other functions, once an organization reaches a certain size, specialism tends to become necessary for efficiency and someone is likely to be tasked with managing purchasing.

A typical SME with a few hundred staff might have a purchasing department of two or three people. In the biggest companies, purchasing

departments often comprise several dozen people responsible for different aspects of the buying and supply management operation.

Raising the profile

Purchasing has traditionally been a low-profile function. Very often it has been the department where people deal with the administration surrounding purchases: signing invoices and matching them to purchase orders, answering enquiries from suppliers and keeping records.

It has often been an unglamorous, bread-and-butter department where life passes uneventfully. In this kind of scenario, the department's boss doesn't wield much influence with the higher-ups and is unlikely to be involved in discussions about the organization's strategy. The board doesn't pay much heed to what purchasing is up to because it isn't considered very important.

While it's still like this in many organizations, it is changing. In the past ten or twenty years many companies have taken the first steps towards giving purchasing and supply management the attention it deserves. In part, circumstances have forced the change. Increasing competition and a difficult economic climate have led companies to look for ways of becoming ever more efficient.

In the 1980s 'downsizing' was the order of the day, when companies cut costs by reducing the number of staff on their payroll. This had the

advantage of being quick and effective, but as many organizations later realized, the danger is that expertise gained by individuals over many years is thrown out and proves impossible to replace when it is needed again.

The ability to squeeze costs by cutting numbers is limited, so many organizations looked for other ways to become more competitive. Some realized that there was money to be saved from the huge amounts spent on goods and services. They saw that reducing purchasing costs could improve profitability – often dramatically. In the case of public-sector organizations such as schools or the health services, this means that the money saved can be diverted to paying for what really matters: the front-line services of teaching children or treating the sick.

The new interest in the purchasing function has continued to grow as reform of spending operations in companies and public bodies has steadily produced results. Purchasing has been given a new lease of life and those involved in it are gaining status, not only in their own organizations but also in the wider business world.

It is a trend that seems certain to continue. In 1997, according to research by business analysts Gartner in the US, very few chief executive officers would have even known the name of their senior procurement professional. But ‘the recent intense interest in procurement means that senior executives across all industry sectors are beginning to realize the true potential of procurement’.

By 2007, Gartner says, at least half of the biggest global companies will have a chief procurement officer reporting directly to the CEO.

What do purchasing people do?

As we have said, everyone is in some sense a buyer, but many organizations are now appointing specialist purchasing professionals. Nevertheless, there is a long way to go in most organizations before purchasing becomes a highly developed function on a par with sales, finance, marketing or HR.

The potential for change in many companies and public-sector organizations is thus huge. But the study of purchasing and supply management as a business function is still in its infancy and for most people it is difficult to know where to start.

Much of the research into purchasing and supply chain theory so far has been concerned with mapping out what is involved in it. Unlike more developed functions, people studying this still often ask themselves: 'What do purchasing and supply management professionals actually do?'

A major study due to be completed in 2004 will attempt to answer this question. The four professional institutes whose members work in purchasing, supply management and logistics have joined forces to analyse the skills needed by people in more than 50 identified roles.

The findings of the Polemics project will be used to make sure that professional qualifications are more relevant to industry as part of a government drive to raise skills levels in the UK workforce.

Information is key

The basic ideas involved in professional purchasing and supply management are fairly simple. There is no need to grapple with complex statistical formulas or difficult management concepts, though these have their place. More important is to understand the ideas involved. Once you can see where you're going, the means of getting there will become clearer. As psychologist Kurt Lewin once said: 'There's nothing so practical as a good theory.'

Often the basic information needed to make real changes is lacking, because historically very little attention has been paid to the way in which purchasing is organized and what it does. Consequently, there is often a complex web of purchasing activities in most organizations that is very difficult to analyse, and even more difficult to organize into a rational and controllable function.

That means that purchasing and supply management consultants – a growing breed of experts – spend a great deal of time grappling with questions about who is spending money in organizations, how much they are spending, who they are spending it with and whether they are getting good value.

Supply chains

Terminology is often a stumbling block when trying to understand the issues involved in purchasing. 'Supply chain', for example, is one of the expressions commonly used to describe a concept of which most people in purchasing will have heard. It's important that they should understand what it means, because they are part of it, and if they feel they are involved in something more important than merely placing the next order, it will help develop an understanding of the bigger picture. For many purchasers, seeing themselves as crucial players in the economy as a whole will be highly motivating.

The idea of a supply chain is based on the concept of a string of organizations along which items are passed while in the process of being developed. A manufacturing company will typically buy raw materials – metals, plastics or other commodities, for example – and transform them into an item that may then go on to the next link in the chain. The next company in the chain will carry out further processes before the item finally ends up being sold as a product in the shops and supermarkets.

In the motor-manufacturing sector, for example, several thousands of suppliers are typically linked together to contribute to the finished product that ends up in the car showroom.

This basic understanding applies just as much in the services sector, even though the product on sale is not a tangible object. IT services, for example, often involve highly paid teams of people installing expensive machinery or providing business advice. These activities are probably a

crucial aspect of the company's operation and a high-cost one at that. If a company is selling IT services, it is a supplier and is therefore, it can be argued, part of a supply chain.

However, many experts now question the concept of the supply chain, pointing out that in reality the links between organizations are far more complex than the term suggests. They often look not so much like a chain as, for example, a network of many organizations linked to one another in different ways. So they argue that 'supply networks' is a more accurate way of describing these relationships than 'supply chains'. These are simply ways of understanding how things work.

Who is spending money?

One of the first tasks to address if you want to bring your purchasing/supply management function under control is to find out who is spending money. This may sound like a very simple question, but for most organizations it is a very difficult one to answer.

There are usually a few people whose roles may clearly involve purchasing, at least from time to time. IT managers typically deal directly with contractors and suppliers and often manage very big spending budgets. The HR department may make its own decisions about spending on goods and services ranging from software to writing projects. Engineers have traditionally bought their own goods as they are the ones who know what to buy.

However, in most organizations there will be many other people who spend money. Most of the spending will be 'historical' – no one knows when it was decided that they would take responsibility for their purchasing. It seems as if it has always been done that way.

Often there will be others who spend money from time to time even though this has never been officially sanctioned. 'Maverick spending', as this is known, is the bugbear of the professional purchaser. Although it can often amount to quite large amounts of money, it is completely unmonitored and uncontrolled.

Increasing value through purchasing

Cost: The quick fix

Of the various ways in which improving an organization's purchasing and supply management function can bring benefits, the most obvious is cost reduction. As we saw early in this chapter, reducing fixed and variable costs through effective purchasing strategies can help increase profits. Furthermore, it can be argued, the savings available through a more efficient purchasing operation can be of far more immediate benefit than raised income from sales.

The argument goes like this: Suppose some smart purchaser realizes that the price being paid for widgets can be cut by 20%. Instead of spending

£100 000 a year on this particular type of widget, the company can source the same item from another supplier for £80 000.

The £20 000 saved has an immediate impact on the company's relative profits – it goes 'straight to the bottom line'. Or it can be reinvested to improve the quality of the product or to reduce its price in the marketplace, thus sharpening the company's competitive edge. In the case of public- and voluntary-sector organizations, the money saved can be used to improve services.

To achieve the same benefits through increased sales would mean a huge increase in volumes sold. If profits average, for example, 20% of sales income, each £100 000 of sales would generate £20 000 of profit. So to create the same £20 000 extra profit, our imaginary company would have to double its sales.

There are two main areas in which purchasing costs can be cut: spending with suppliers and transaction costs.

Cutting spending with suppliers can mean, for example, securing lower prices by aggregation: putting all the orders for an item, previously perhaps generated in different parts of the organization, together into one big order, and negotiating discounts based on volume.

Or it may be possible simply to find suppliers who offer a better deal. The incumbent may be inefficient and offer poor value for money; researching the market to identify whether other suppliers can give a better deal is a fundamental part of the purchaser's job.

It may also be possible to negotiate a better deal with the existing supplier, especially if the purchaser is armed with information about other companies offering better deals. It is considered good practice regularly to 'benchmark' suppliers against their peers – taking prices and other factors such as reliability into account – to make sure that they remain good value for money.

The other major way of saving through purchasing is to reduce what are known as 'transaction costs'. These are the costs of the transaction involved in making a purchase, not including the amount of money paid for the item. How this is measured is open to interpretation, but should ideally incorporate everything, including the cost of running the purchasing department. So the transaction cost involved in a single purchase can be worked out by dividing the total cost of a purchasing operation by the number of transactions it handles. It follows that transaction costs can be cut by reducing the costs involved in running the purchasing operation.

Quality

Professional purchasing is not merely about cutting costs, important though that is in today's competitive world. In a slightly less immediate and direct way, a properly run purchasing department can bring huge benefits to a company by improving the quality of its product.

Consider cookery. The first rule of good cookery is to use the best ingredients. No amount of culinary expertise can cover up for substandard raw materials. You can't, as the saying goes, make a silk

purse out of a sow's ear. The same applies to any product in the world of industry and commerce. As the person who knows what is available on the market, how to get hold of it and how much to pay for it, the purchaser is in the best position to make sure that the best ingredients are being bought.

It is possible, of course, to go for the lowest price at all times. Quality generally costs more. So there is a balance to be reached between cost and quality: as a generalization, the more you pay, the higher-quality goods or services you are likely to receive.

But that is the simplest way of looking at it and, as everyone knows, paying more does not necessarily mean getting better value. In reality the world is more complicated. It's the professional purchaser's job to make sense of the complex issues involved and come up with the best possible deal in terms of both cost and quality. The big question is how to achieve maximum cost-effectiveness.

Optimum cost-effectiveness will depend on several factors, including what use the bought-in item is going to be put to and how crucial it is in the production process. The decision on cost-effectiveness may also be affected by how much money is available to spend. It would make no sense for a purchaser to insist on buying the very best available on the market if the company can't afford to pay the bill.

There is also the question of how important the purchaser's employer believes quality to be. Or, to put it in a more practical way, whether the

company's customer is paying for top-quality goods or is happy to make do with lower standards.

A factor gaining increasing recognition as one that can bring huge benefits to an organisation in the marketplace is the innovation that suppliers can bring. Suppliers are generally in competition with one another and the way they gain competitive edge, apart from factors such as price and reliability, is through offering better goods or services than their rivals. Innovation is a key driver for suppliers and an astute purchaser will take full advantage of this.

Reputation

An even bigger issue in which the professional purchaser is often involved is how relationships with suppliers can affect an organization's performance in the longer term. One increasingly crucial factor in this concerns image and reputation.

Nowadays there are much more complex and longer-term questions to consider than the simple cost of an item or its specification. What organizations buy and where they buy it from can also affect far more than immediate profitability.

No organization wants to hit the headlines because one of its suppliers exploits children in the developing world or is destroying a wildlife haven. Most organizations want to be thought of as dynamic and commercially minded, but they also want to be seen as responsible. This is not just a noble aspiration but good business sense.

Increasing long-term value

The various ways of increasing value through purchasing can be seen as a progression in which an organization can become increasingly sophisticated. As purchasing skills and experience develop, it can move from a strategy of implementing the simplest way of boosting immediate short-term value – cutting costs – through increasingly higher-level activities bringing longer-term value. Figure 1.3 shows the progression from cost cutting to improving reputation and the consequent rise in an organization's long-term value.

The prize

There is therefore huge scope in almost every organization for examining exactly what is being bought and whether it provides value for money. One of the winners in last year's CIPS/Supply Management awards was the Pennine Acute Hospitals NHS Trust. This example shows how effective purchasing can make a real difference.

The trust's supplies manager, David Scott, who also won an individual award, discovered that endoscopy equipment, used in internal examinations, had been bought from the same supplier for 27 years without ever being put out to tender. So Scott put the items out to tender and ended up buying 12 new endoscopes at a saving of 33%. One examination room was completely refitted and a total saving of £140 000 was secured over the seven-year life cycle of the product.

Scott spread the word and several other NHS trusts took advantage of the same deal. It is now being extended to trusts nationwide at a projected saving to the NHS of £15 million a year.

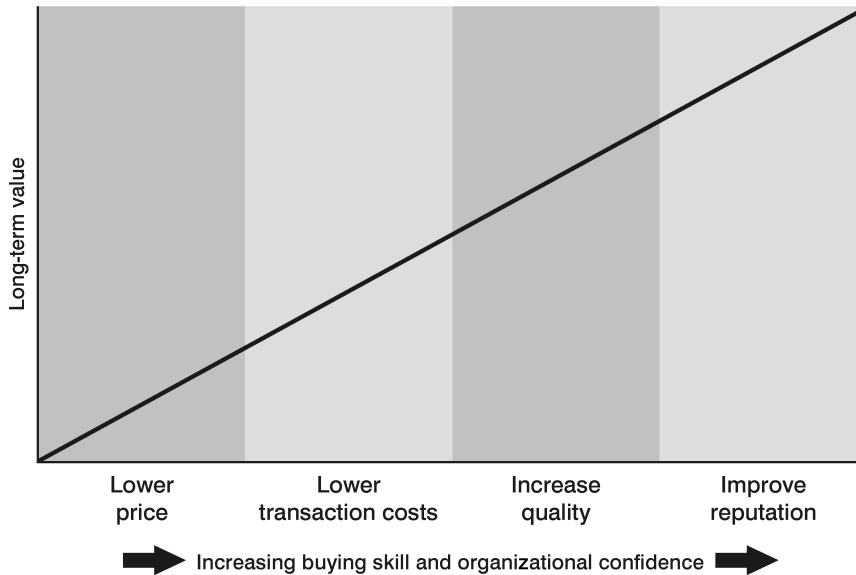


Figure 1.3

One of the judges for the awards said that this was ‘an excellent example of one purchasing department challenging the status quo and stimulating a change in attitudes throughout the public sector’. He added that it was ‘the best thing that has happened in health service purchasing for a long time’.

The new equipment was not only much cheaper but also more reliable, easier to maintain and less uncomfortable for the patient being examined. Everyone was a winner – except the original supplier who failed to keep up with technological developments and, in the end, lost out.

This was just one piece of equipment found in any general hospital. The savings that could theoretically be made if the same approach were applied to all health service spending are incalculable.

Concluding thoughts

The purchasing function plays a crucial role in most organizations, yet many still haven't recognized its importance. How many of us would take such a casual attitude to buying a house or car?

Companies usually spend large amounts of money on bought-in goods and services. Yet many don't know who is spending that money, how much they're spending, or who they're spending it with. They are like charitable institutions keeping inefficient suppliers in business.

The savings that can be achieved from streamlining purchasing are huge. Nevertheless, many organizations still haven't got round to looking at it closely. Shareholders, customers and the public would soon start asking questions if they realized how much money was being wasted.

It's clear that purchasing as a function ought to have a voice on the board of management in most organizations, but this is very rare. How can purchasing professionals start fighting their way to the top?

Most professions have their stars – people who are recognized as being excellent at what they do and an example to all, as well as first-class communicators who know how to use the media. Yet it's hard to name any such gurus in the world of purchasing and supply management. It's time for a few ambitious individuals to step into the limelight.
