
Strategic Role of Procurement: Its Emergence and Development

T. Kurt Warren

Abstract: *The aim of this paper is to seek the understanding of what strategic procurement is and how it's evolved from its humble beginnings as a non-value added function of a buyer to an important function within the corporate world. We will discuss the concept of organizations having a strategic procurement function and why it is vital that it has representation in the boardroom, along with buy-in from the corporate world of its importance in the profitability of the organization and the management of two of its most important risks 1) reputation and 2) supply of products and service.*

Contents

Introduction 2

Strategic Role of Procurement: Its Emergence 2

Strategic Role of Procurement: Challenges..... 4

 Risk Management..... 4

 Career Profile 6

 Corporate Acceptance..... 6

 Elements of Strategic Procurement 7

Strategic Role of Procurement: Advantages 8

Conclusion 9

References..... 11

Introduction

To fully understand the impact strategic procurement can offer, one only has to look back at the evolution of the function. It was not so long ago when the following could be heard across many companies: “Procurement is a bunch of lazy and useless people who add no value”, “Buyers adding value!!! Don’t make me laugh, all they do is go to lunch or play golf with vendors”, “Purchasing is a profession for person who does the job just because he was rubbish at manufacturing”, or “They just get in the way and stop me doing my job”. Comments like these were mainly coming from places like manufacturing companies where they perceived buyers as an unnecessary burden and hindrance to their work. Whilst the executives perceived them as a transactional administrative function for finance rather than a value added (Personal communications, 1990’s, Zheng et. al., 2007, and Paulraj et. al., 2006).

There has been a paradigm-shift in the role of purchasing and the evolution of a procurement function within the business community. Some organisations take procurement to another dimension by establishing a supply chain function that procurement is part of its vital links. In the past several decades there has been a significant shift within many manufacturing industries from the original relationship of purchasing as a non-value added business function; buying the items required as defined in the materials resource plan (MRP); to the start of the evolution of procurement as the introduction of materials resource planning II (MRPII). This led companies to question “Make or Buy” In addition to the establishment of global manufacturing organisation with facilities throughout the globe, supported enterprise resource management (ERP) and distribution resource planning (DRP), Baily et al (2008) has led to procurements fully emerging as a value added function. In addition to the emergence of e-commerce and portfolios of new procurement tools available to the professional procurement organisation such as e-procurement, e-auction and online procurement and the emergence of category management, partnership agreements and collaborations. As well as supply chain optimisation such as value streams pipeline management, lean and agile supply. Research has shown that many factors had contributed to the paradigm-shift and the senior executives had established positions within the boardroom like Chief Procurement Officer (CPO) and Chief Supply Chain Officer (CSCO) Nixon (2011). The factors that have led to such change in corporate strategy goes back to the question “make or buy”, driven by issues with 1) trade unions, 2) high costs associated with manufacturing, 3) skill gap and the customers voice / vote and 5) the global economic recession.

This paper will focus on the elevation of the procurement function as strategic and why many organisations find it difficult to achieve.

Strategic Role of Procurement: Its Emergence

The world has become a much smaller place regarding global markets and business transactions which are realised in a short period of time. Resulting in the global market available, not just to the initial entrepreneurial companies, who were the pioneers and risk takers in sourcing from low cost countries, but now available for everyone, through ecommerce, Baily et al (2008) . Reduced costs in the supply chain manifested itself into the emergence of international retail brands offering well known and desirable brands at retail price the general public can now afford creating a wave of customers electing to buy items from these organisations without any forethought of the supply chain or the ethics behind their purchase. The key drivers here are what cost customers will pay and what profit businesses will make.

Manufacturing companies have to look at their historic manufacturing practice and search for ways to reduce costs, which are uncontrolled, thereby focusing on the supply chain costs and the realisation of procurement's important role not only to the P&L but the survival of the brand and/or company. Procurement now provides more business strategy solutions to the senior management. Expediting the finished product or components would be a better option than manufacturing the product within the company or changing the function of the manufacturing facility as an assembly operation (value added), resulting in the decline of manufacturing and business restructuring themselves as value added or trading companies, closing down manufacturing facilities and layoffs of vast amounts of skilled workers.

However research has shown paradigms shift. Customers have become more educated in the true cost of the product and ethical practices within the supply chain due to social media and the news exposing the dreadful conditions workers and children (child labour) are having to endure for the high value and desirable retail brands now manufactured at a fraction of their retail price. In addition, the control of quality comes at high cost and high risk, with the procurement and quality departments located thousands of miles away from the manufacturing facility. Reputational risk of the global brands is now one of the key risks for any business, Jeynes (2002). The result of a well-known brand being exposed in social media, regardless if it is founded or unfounded allegation, of any form of unethical corporate activity shows the voice of the customer and their ability to vote with their feet by moving their purchasing power to a competitor.

There is now a lot of literature and media information on the economic emergence of these low cost manufacturing counties, like China and India becoming OEM manufacturing players in their own right, resulting in the rise of the GDP and the workers of these countries to demand better wages and living conditions. Making the actual unit cost, known as total acquisition cost (TAC) (Figure 1), having an adverse effect on the P&L, thereby making the senior management revisit the "make or buy" decision and the CPO realigning the procurement strategy to support in-house manufacturing.

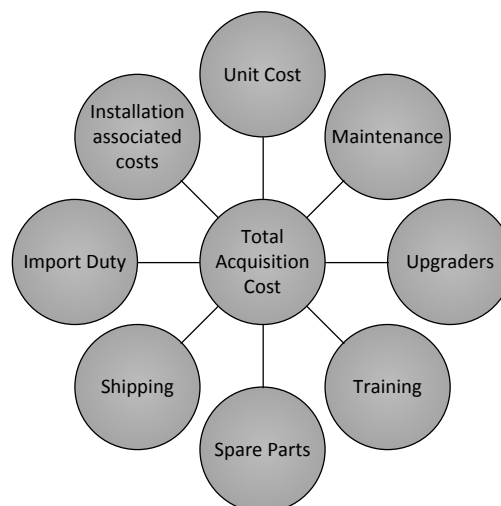


Figure 1: Elements of the TCA

In addition to the above mentioned factors, there is the risk factor of intellectual property (IP) and copying products to sell at a reduced price; either as a direct copy or a replica product with different branding. Both have considerable risks to the company of the reduced sales associated with the rebranded copy or the customer's voice on social media if they have bought a "fake" that looks identical to certified original. Therefore the strategic procurement

department is now a value added department with a remit not only procuring products at the best price, but needed to a more strategic function. These functions include any activity which aligns to the values and mission of the organisation e.g. looking at cost, ethics, risks, vendor management, collaborations and supply chain optimisation, thereby bring a whole new dimension to the “make or buy” decision process (Figure 2).

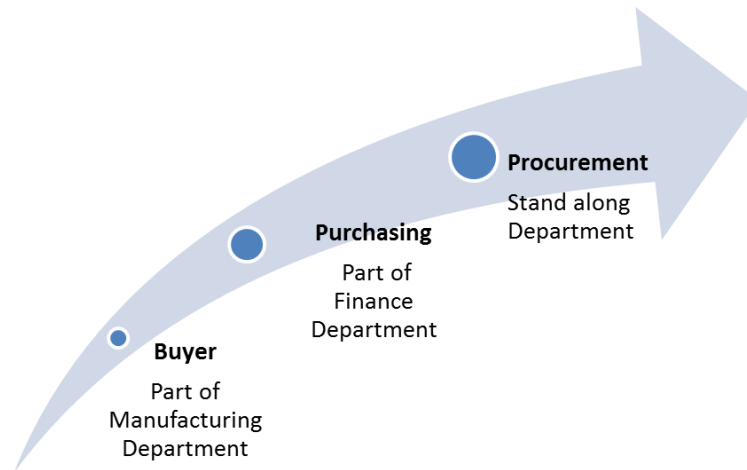


Figure 2: Evolution of procurement

Strategic Role of Procurement: Challenges

There has been a lot of research discussing reasons behind “why it is both difficult and important to adopt a strategic approach?”. Payne et. al., (2012) mentioned that “*Procurement should be using a process called “strategic sourcing” to help shift buying from tactical to a more strategic function*”. On the other hand, Nixon (2011) explained “*Many executives are increasingly looking at procurement to engage the business in strategic conversations about how the supply chain can be optimised to deliver the greatest returns*”. Furthermore, Johnson et. al., (2002) emphasized “*evidence indicated that the purchasing function in many organisations has moved from being clerical to strategic*”.

Like any business strategy, it has to flow from the top down, with everyone in the organisation focused on the mission and vision of the organisation. The strategy for the strategic procurement function has the same focus and support as any other function in the organisation. Fergusson et. al., (1996) explained the overall level of purchasing participation in corporate strategy planning process increased because it has an impact to the P&L and to the reputation of the company. It must have the support of outside influences like; shareholders, trade unions, marketing and the customer.

Risk Management

Enterprise risk management (ERM) is one of the most important considerations of any company (Jeynes, 2002). Risk associated with strategic procurement decisions could possibly be the most dramatic affecting the organisation (Figure 3), affecting not only the P&L directly but indirectly damaging the reputation of the organisation, resulting in legal proceedings, exposure on social media, and the customer’s voice.

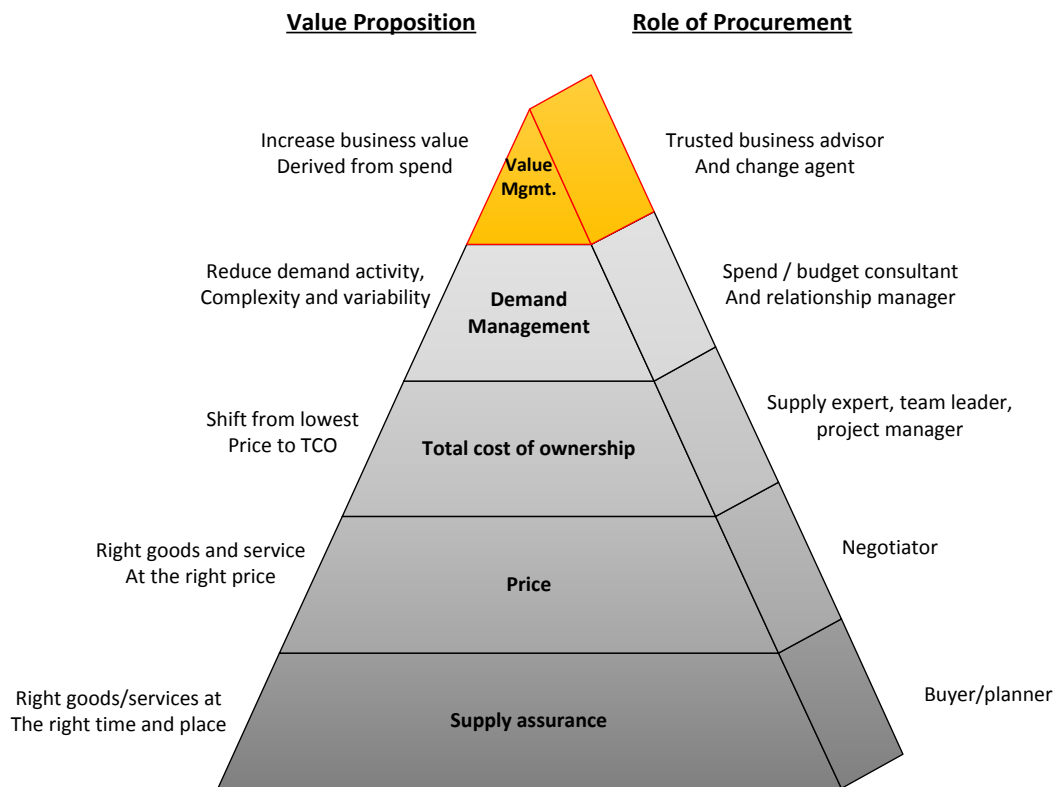


Figure 3: Procurement's evolving value proposition (Source: Connaughton, Rao Dabbera and Sawchuck, 2014)

In addition, the board has to consider the international laws involving; embargos, sanctions, export control (IATR, OFAC, EAR, and EAR99) and political situations within the country supplying goods. Jheng et. al., (2007) indicated there is statistical evidence to support the argument that the impact of strategic procurement has indeed had an impact on corporate success. This is where strategic level of procurement has a distinctive advantage over transactional operational level of purchasing (Figure 4) as they manage the risk of the supply chain and provide direction to the board; the risks and migration of the risks to ensure the supply of goods.

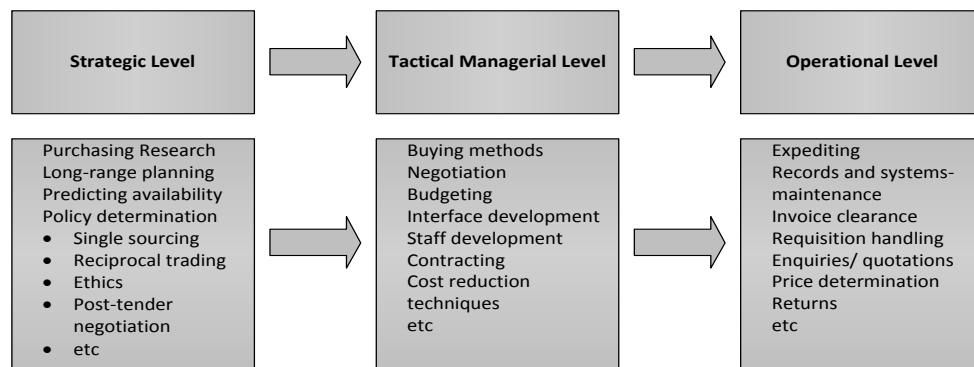


Figure 4: Strategic, Tactical and Operational

Career Profile

The function of the buyer in the early 90's was one of low grade which was administered by a person who was removed from a technical position in the company or a direct employee with a basic level of education. With the emergence of IT systems, ecommerce, and material planning processes (MRP, MRPII, ERP& DRP), the level of personnel to support these processes has had to increase from basic to full degree. Now we are seeing the minimum requirement of a MSc or MBA for procurement positions. Additionally, it is always preferred to speak multiple languages and have various degrees of years of experience. Some companies depending upon their business portfolio also require enhanced screening of their staff to ensure there has been no criminal history, which could affect the companies' ethics or risk to organisation.

In a recent conference in Liverpool (UK) there was much debate about the shortage of supply chain personnel and the need for more professional graduates to enter the procurement and supply chain profession (jps-supplychain.co.uk, 2015). This is one reason why many academic institutions like Salford are offering MSc's dedicated to procurement, logistics and supply chain. The chartered institute of procurement and supply (CIPS); a United Kingdom organisation, has emerged as one of the world's leading provider's courses and qualifications in the all aspects of procurement and supply chain management. They also have seen the change in the importance of procurement over purchasing by replacing purchasing in CIPS to procurement, and more recently CIPS have been awarded chartered status by HM the Queen, which brings them in line with other professions like accounts, architects,...etc. However the UK is not alone in this, the American Purchasing Society (APS) and other countries' purchasing institutions have realised the need and demand for educated professionally qualified personnel.

As indicated the demand is high and the availability of good personnel is becoming more difficult to find: The cost of gaining CIPS, APS or an MSc is both time consuming and expensive. Proactive organisations are now seeing the value of retention and development of their procurement / supply chain staff by providing financial aid to ensure not only personal development, but continuation of development for the department.

Corporate Acceptance

Without acceptance from the highest levels in senior management or recognition from the corporate world of the strategic importance of the CPO or CSCO in the boardroom, the concept of strategic procurement will never mature to a point of realisation. This is partly due to the global recession where statistics show procurement as one of the few areas within organisations not affected by headcount reduction. In fact it increased, along with remuneration packages to ensure retention (Figure 5). Indeed, Pennino, (2012) agreed by saying *"Today's chief procurement officers or heads of sourcing and supply chain are becoming as prevalent and as vital in the preservation and the performance of a company's bottom line as chief technical officers"*.

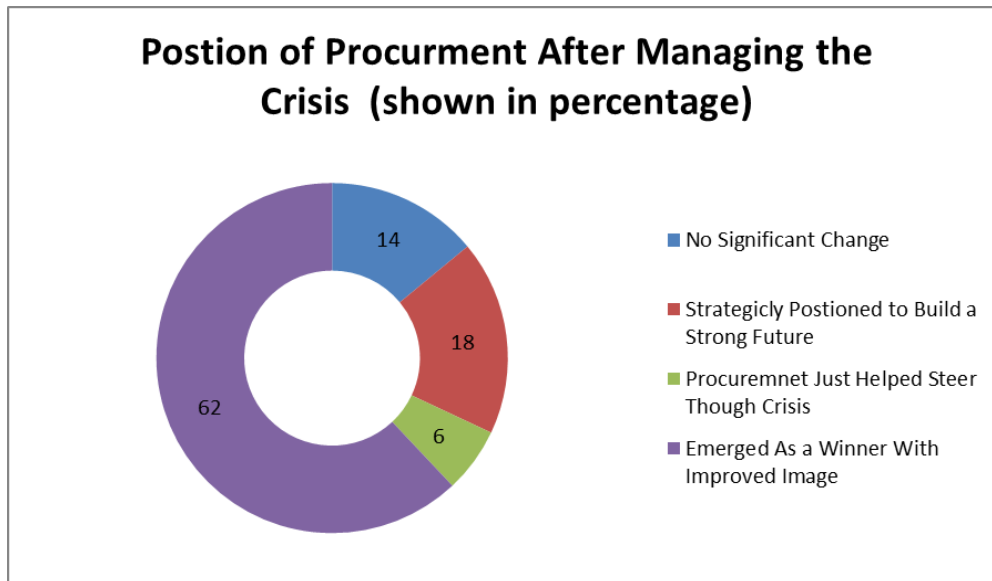


Figure 5: Position of procurement after managing the economic crisis (Source: Institute for Supply Management, 2011)

To reinforce the argument for the importance of a strategic procurement function a recent research study conducted by the Hackett group (2014) on the strategic priorities for today's COPs, it illustrated; *"The best procurement organizations are pushing a procurement strategy that address not only the immediate challenges of the recent recession, but also forward-looking initiatives that will enable the procurement function to deliver maximum value to the enterprise as recession turns to recovery and growth"*.

Elements of Strategic Procurement

Vendor Management

In their report "Business as usual is Not an Option", Labowitz and Baumann-Pauly (2014) discuss issues relating to poorly managed vendors and supply chain. They explain "disaster of Rana Plaza" where the building collapsed and many workers lost lives or were seriously injured. It examines the issues relating to supply chain where the contract was given to a registered supplier (X) who was behind schedule and needed additional capacity, so they subcontracted to an unregistered company (Y) who in turn subcontracted to company (Z). When disaster happened and investigations took place, the complete supply chain was unravelled and laid open in front of the world to see: The conditions in company Y&Z were well below the standards of a registered company. The result of such a public disaster and exposure of the appalling conditions of the companies was devastating for the U.S organisation using company X to supply their goods led to perditions against the U.S Company, investigations by the Federal Government and online campaigns. Customers in turn bought from alternate companies.

Ethical Procurement Activity

The phrase "Buy the Buyer" was often used in the very early days of trading, where vendors would "grease the palm" of the buyer to get the business or make the deal. Unfortunately, this still happens in some places in the world due to low wages, cultural differences to western ethics of business and individual corruption. CIPS have been one of the driving forces in educating professionals and companies in the ethical behaviour expected by the employee and company. Awarding recognition of understanding to both individual and company as an ethical procurement and supply chain professional (CIPS.org., 2015). This is now seen as a marketing

tool to prove to the customer they take corruption, slavery, exportation within the supply chain, seriously and have measures to ensure no such activity is within the their supply chain.

Export Control Vendor / People / Goods and Payments

Global trade is changing every day with sanctions, embargos and individual country restrictions imposed by the U.S, UN, EU through legislative bodies like OFAC, IATR and EAR. In recent months the U.S have imposed sanctions and embargos on a European country, this would have never been thought of a few years ago (Treasury.gov). But trouble in Crimea has led to a member of the European community under both US and EU sanctions. Venezuela also joined the sanction list with regard to Iran, in addition to over 3500 individual sanctions list showing the importance of vendor management and the need for a strategic look at the supply chain, not only of the goods but also the route of payment, if the payment is in US Dollar. Violations to export control legislation can incur large fines, imprisonment and notification the company has received a penalty for trading with an embargoed or banned country, causing catastrophic effect to the company as vendors and customers distance themselves. In research it was proved that even if the allegation is unfounded the financial impact to the origination could cripple it in legal fees to prove innocence. Strategic procurement professionals must have a clear understanding of these risks and ensure they have risk mitigation plans and documentation to support (Treasury.gov).

Strategic Role of Procurement: Advantages

Demonstrated earlier were reasons organisations didn't see the need for a strategic procurement function. In this section we will seek understanding to why this function is critical to the organization. Nixon (2012) states *"the evidence indicates that the majority of Procurement functions till don't have a strategic role and are generally not considered (nor optimal delivering) as a true partner to the organisation"* and later suggests that *"Across the board, COPs will need to place more focus on becoming effective change leaders"*. The evolution of procurement has taken the same path as the introduction of MRP through to ERP as well as companies looking to move into a more global market with physical presence in low cost countries. With the emergence of international companies with offices, manufacturing, distribution and franchise operations each with their own demand of products, duplication of the same product or product group occurs often. This is where strategic procurement comes into play and looks at the aggregated demand across the group creating category of spend, utilisation of subject matter experts (SME's), to drive through commonality of products and fully utilize the aggregated volume to negotiate global contracts thereby reducing the number of vendors, cost and risk to the organisation. *"Companies that take advantage of the opportunity to optimize their spend operations now will be best positioned for success in the years ahead"* Pennino (2014).

The management of risk has shown without managing the vendor and supply chain significant damage to the organisations P&L and reputation can be caused. This has been the most critical advantage (figure 6) of a professional strategic procurement department which has a seat on board, CPO or CSCO.

Baily et al (2008) support the notion of purchasing becoming a strategic function in the organisation, by explaining a strategic procurement operation can provide a company with corporate advantage by ensuring the supply chain is lean and risk free. Paulraj et al (2006) also confirms there has been a growing importance of the supply chain management that has led to the increasing importance and recognition of the strategic role of purchasing.

“Procurement should be using a process called “strategic sourcing” to help shift buying from a tactical to a more strategic function” (Payne, Dorn and Miller, 2012).

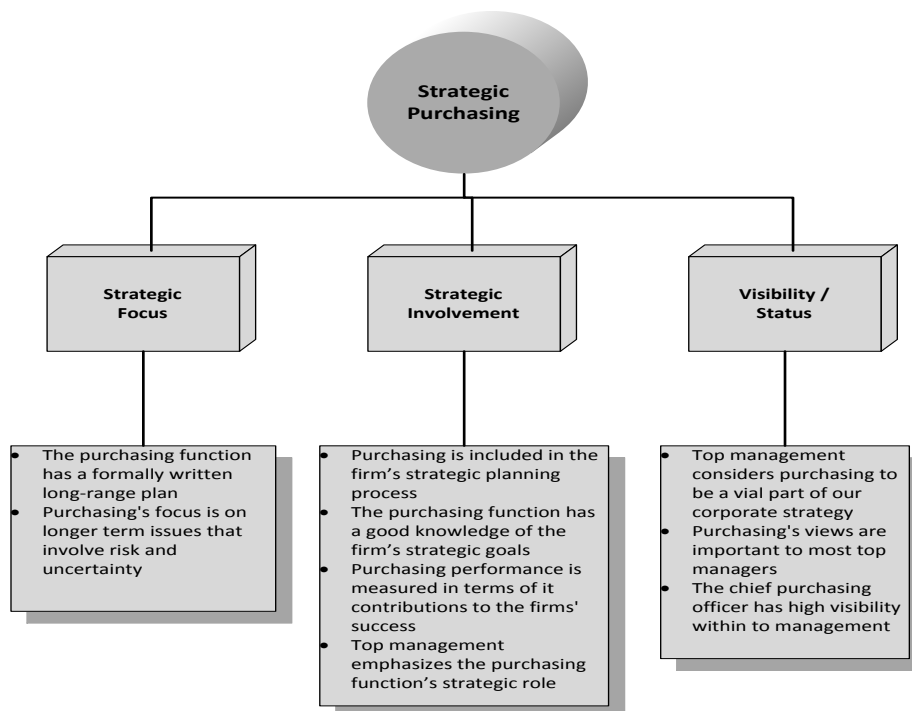


Figure 6: Critical elements of Strategic Purchasing (Source: Paulraj et al (2006))

Mahoney and Stoller illustrate ten critical areas contributing to the success and implementation of a strategic procurement function. These are illustrated in (Table 1).

1. Procurement Strategy	6. Supplier Relationship Management
2. Tools and Technology	7. Culture and Change Management
3. Source -to- Pay Process	8. Contract Management
4. Organizational Structure Alignment	9. Inventory Management
5. Category and Spend Management	10. Risk Management

Table 1: Ten critical areas for a successful strategic procurement function (Source: Auxis, Inc, 2009)

Conclusion

Strategic procurement and purchasing strategies cannot be developed in isolation from the rest of the company or have no collation to the mission and vision. To ensure buy-in from senior executives and the organization, they must first recognize the value and importance of the strategic procurement function and in turn provide a seat at the table for the CPO or CSCO at senior management meetings. Once this has been achieved only then can the business process and strategies be aligned with the rest of the organization to ensure the corporate strategy, mission and vision is achieved.

Benefits of strategic procurement functions outweigh risks to the business and the distinct corporate advantage of having the CPO as part of the senior management team. This is confirmed in a report by the Institute for Supply Management, (2011) where they cite eight CPOs stating *“top management expected their teams to improve overall value contribution of*

procurement last year- primarily shifting the focus from short-term cost cutting to long-term, value-based relationships with suppliers”.

A final thought regarding the evolution of buying to its new strategic function: It has been proven cost reduction is the primary function of buying and no longer the main consideration for strategic procurement. Business continuity is foremost, ensuring ethical supply of goods and services, ensuring the future and risk free growth and profitability of the organization.

References

- Auxis Inc, (2009). Strategic vs. Tactical Procurement. Shifting Focus Towards Value Creation. [online] Coral Gables: Auxis, Inc. Available at: <http://www.auxis.com> [Accessed 9 Mar. 2015].
- Baily, P. (2008). Procurement principles and management. Harlow, England: Prentice Hall Financial Times.
- Bis.doc.gov, (2015). BIS Website. [online] Available at: <http://www.bis.doc.gov/> [Accessed 14 Mar. 2015].
- Connaughton, P., Rao Dabbera, S. and Sawchuck, C. (2014). How Leading Procurement Organizations Outperform Their Peers. [online] Thehackettgroup.com. Available at: <http://www.thehackettgroup.com/procurement-strategy/> [Accessed 4 Mar. 2015].
- Farmer, D. and Weele, A. (1995). Gower handbook of purchasing management. Aldershot, England: Gower.
- Institute for Supply Management, (2011). Great News for Up-and Coming Supply Managers! Procurement Has the Limelight, Post-Recession. [online] Institute for Supply Management. Available at: <http://www.ism.ws> [Accessed 14 Mar. 2015].
- Jeynes, J. (2002). Risk management. Oxford: Butterworth-Heinemann.
- Mitchell, P. and Lamoureux, M. (2015). CPO Job Description: Aligning Procurement With Other Business Functions. [online] Spend Matters. Available at: <http://spendmatters.com/cpo/examining-the-cpo-job-description-part-6/> [Accessed 8 Mar. 2015].
- Mitchell, P. and Lamoureux, M. (2015). CPO Job Description: A Procurement Leader. [online] Spend Matters. Available at: <http://spendmatters.com/cpo/tearing-apart-cpo-job-description-part/> [Accessed 8 Mar. 2015].
- Mitchell, P. and Lamoureux, M. (2015). CPO Job Description: Developing Procurement Staff. [online] Spend Matters. Available at: <http://www.spendmatters.com> [Accessed 9 Mar. 2015].
- Nixon, R. (2011). The Power of Procurement. Business Leaders. KPMG, pp.1-61.
- NYU STERN, (2014). Business as Usual is Not an Option. Supply Chains and Sourcing after Rana Plaza. New York: NYU STERN Center of Business and Human Rights.
- Paulraj, A., Chen, I. and Flynn, J. (2006). Levels of strategic purchasing: Impact on supply integration and performance. Purchasing and Supply Management, 12 (2006)(12), pp.107-122.
- Payne, J., Dorn, W. and Miller, M. (2012). Procurement's role in maximizing corporate budgets. FinacialExecutive, [online] pp.49-50. Available at: <http://www.fincialexecutives.org> [Accessed 6 Mar. 2015].
- Sirkin, H. (n.d.). The importance of procurement in a global environment. The second in a series of special reports on operations in business. BCG and Wharton University, pp.1-15.
- Tassabehji, R. and Moorhouse, A. (2008). The changing role of procurement: Developing professional effectiveness. Purchasing and Supply Management, 14 (2008)(15), pp.55-68.

Treasury.gov, (2015). Office of Foreign Assets Control (OFAC). [online] Available at: <http://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx> [Accessed 14 Mar. 2015].

Zheng, J., Knight, L., Harland, C., Humby, S. and James, K. (2007). An analysis of research into the future of purchasing and supply management. *Purchasing and supply management*, 13 (2007)(14), pp.69-83.