

Procurement & Supply Chain
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Chapter 7

Purchasing and business strategy

Learning objectives

- The changing international business context and how companies strategically respond.
- The strategic role of the purchasing function.
- How to develop purchasing excellence.
- How purchasing can support the company's business strategy.
- How to develop a differentiated purchasing and supplier strategy.
- Global sourcing as a potential sourcing strategy.

The strategic role of purchasing

Transaction cost economics theory (Williamson, 1981):

- Companies can benefit from economies of scale, learning effects and lower cost by purchasing supplies externally.

Outsourcing:

- Due to the increased outsourcing of business activities, purchasing and supply management has developed into a functional domain of strategic relevance.

Suppliers are becoming more important for competitive positioning of companies.

'Strategic purchasing' focuses on integrating the purchasing and supply function with other domains in the firm.

The purchasing and supply domain still focuses on purchasing's 'bottom line' impact through cost reduction, quality development and technology as companies are unsure of how much involvement they want from suppliers.

- How do companies create value for their supplier networks?
- How do they mobilize their supplier networks to create sustainable competitive advantage?

IS PURCHASING STRATEGIC ... OR NOT?

John Ramsey (2001a) argued that purchasing was strategically irrelevant according to **resource-based theory**, as it could never generate above normal returns.

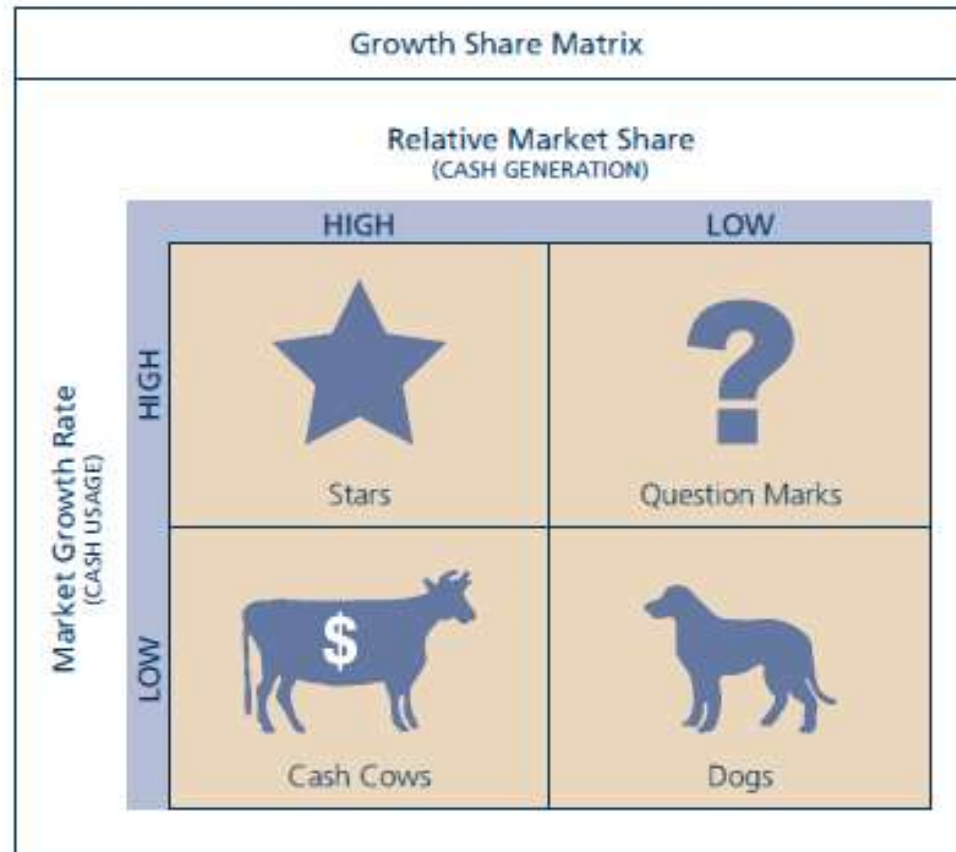
Resource-based view of the firm:

Theory that business success is primarily achieved through deploying a company's unique resources.

Ramsey (2001b) argued it is possible for all sizes of companies could develop superior performance compared to competitors and achieve '**competitive advantage**' that provides for a strategically important role.

Strategic planning and marketing theories

FIGURE 7.1 The growth-market share matrix



Source: Boston Consulting Group

Competitive strategy

- **Michael Porter (1980)**
 - Value chain concept
 - Differentiated between primary activities: inbound/outbound logistics, operations management, marketing and after-sales services.
 - Support activities: technology, development, human resources management, procurement and infrastructure.
 - Preferred 'procurement' not purchasing.
 - Size of company not only factor in profitability.
 - Introduced purchasing-supplier management as a driver of competitive performance.

Innovation & competence management

How is it possible that within one sector some players consistently outperform their competitors?

Resource-based view:

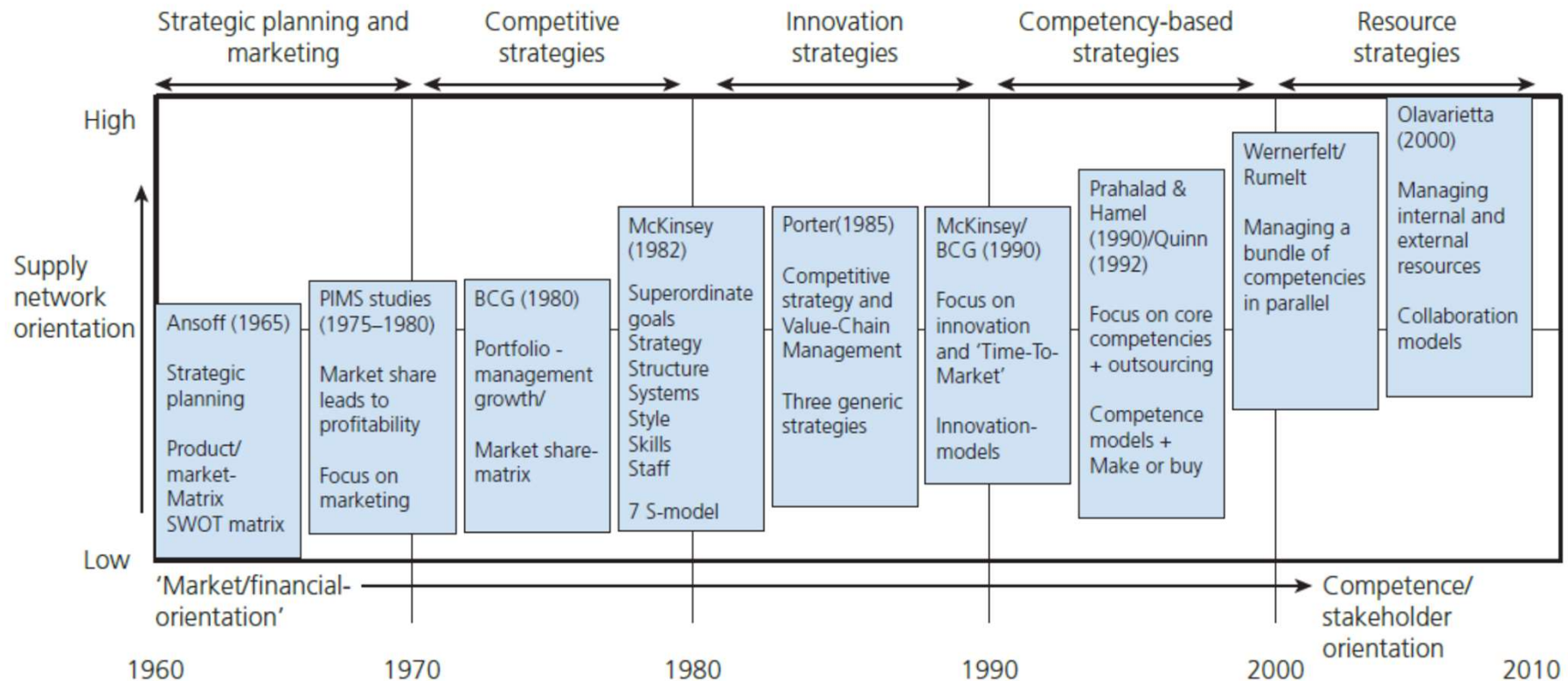
- Rumelt (1991) and Wernerfelt (1984) argued differences in performance and innovation between companies isn't primarily to be attributed to their products or market environment. **Resources** and the way they were used caused differences in performance.
- Prahalad and Hamel (1990) argued that companies should focus on their **core competencies**, whilst outsourcing their non-core competencies to suppliers who do specialize in these non-core competencies.
 - **Core competencies**
 - Those activities through which the company achieves sustainable competitive advantage.
 - **Non-core competencies**
 - Those activities that are conducted within the company that do not contribute to sustainable competitive advantage.

From internal to external resource management

- **Resource dependency theory:**
 - Looks beyond the boundaries of an individual firm.
 - the firm's dependence on other external parties, such as suppliers, is central.
 - Suppliers are necessary for adapting to and anticipating the developments in the supply chain's environment.
 - Securing effective relationships with suppliers leads to securing the external resources required to foster the firm's competitiveness (Pfeffer and Salancik, 1978)
 - Theory that business success is primarily achieved through deploying a company's external and internal resource.

Strategic management thinking

Figure 7.2 Role of purchasing in business strategy thinking over time

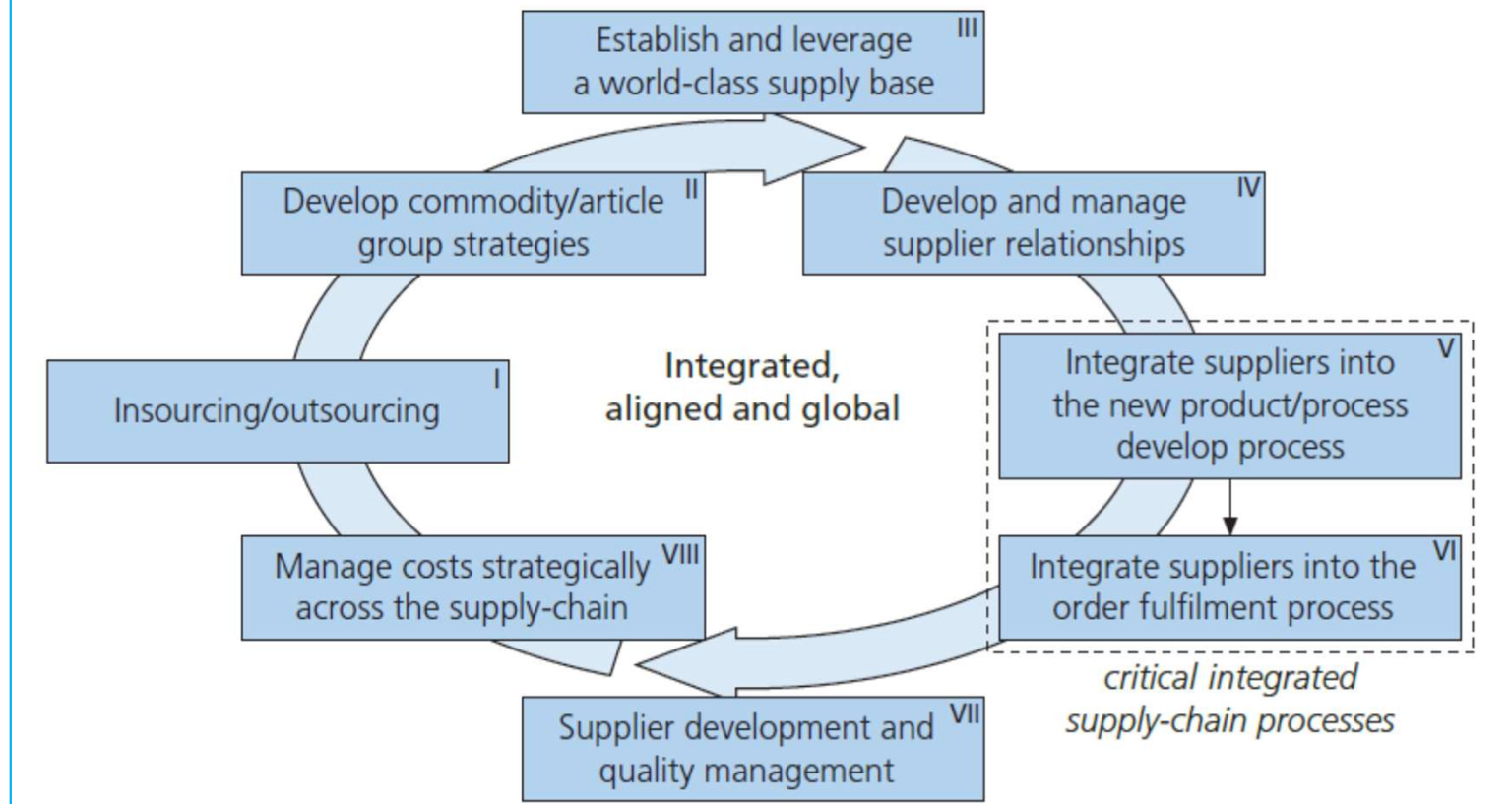


Towards purchasing excellence

Strategic management processes

Figure 7.3 Towards purchasing excellence: strategic management processes

Source: R.M. Monczka as quoted by Purspective (www.purspective.com).



Enabling Processes

Figure 7.4 Towards purchasing excellence: enabling processes

Source: R.M. Monczka as quoted by Purspective (www.purspective.com).

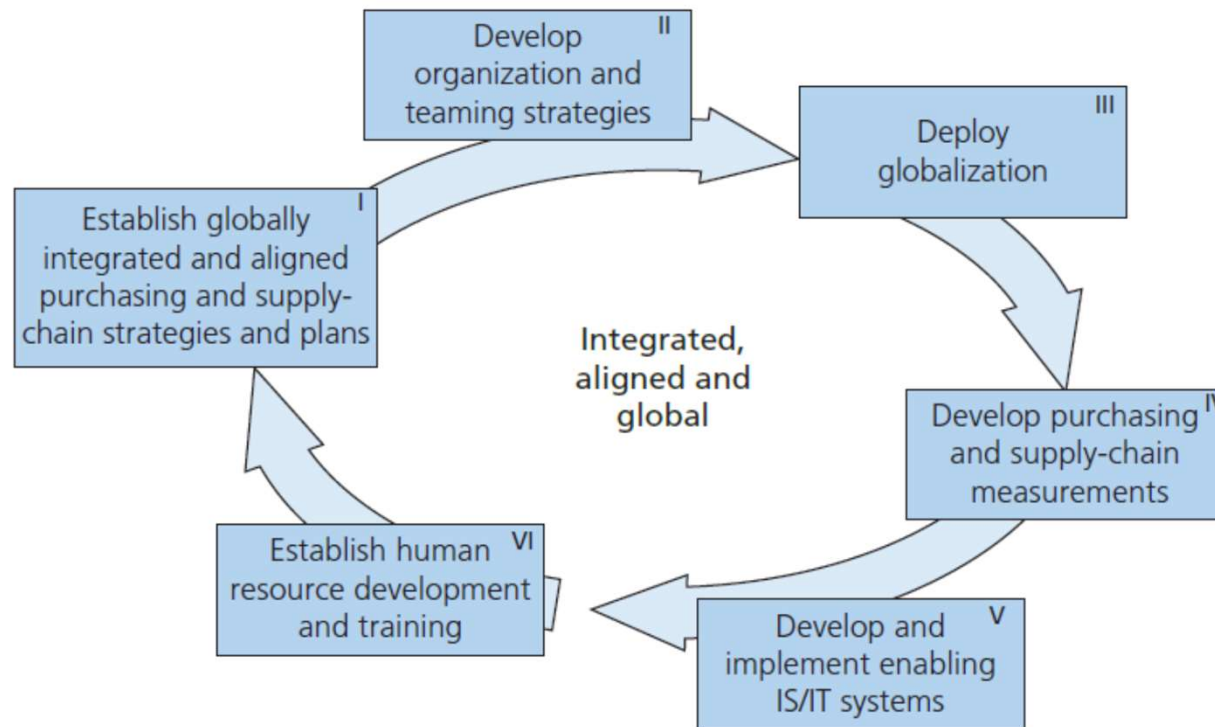


Figure 7.5 Spider diagram: purchasing excellence model



Kraljic's (1983) purchasing portfolio

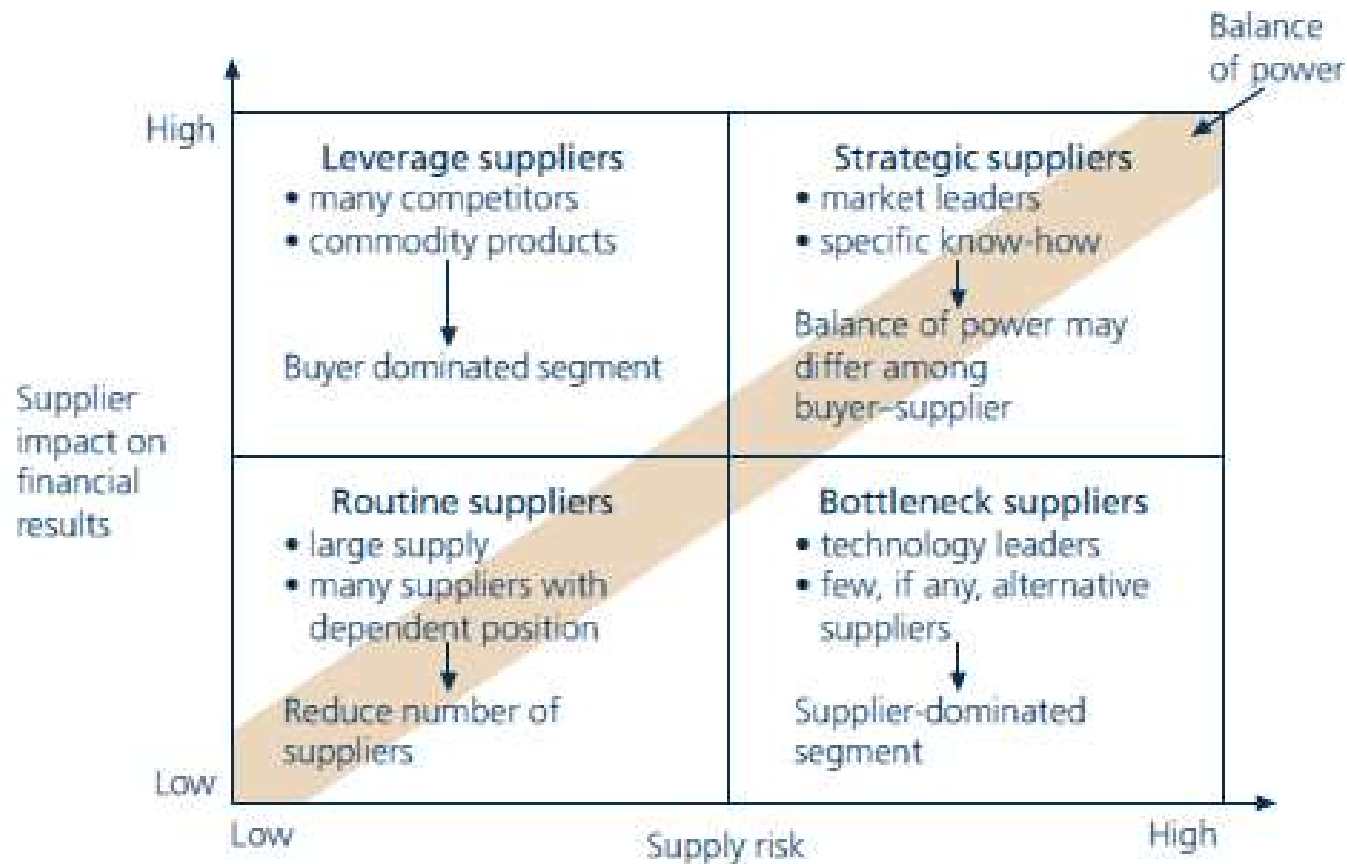
- Purchasing turnover and the supplier base are analysed on two variables:
 - Purchasing's impact on the bottom line to the company.
 - The supply risk.

FIGURE 7.6 Purchasing product portfolio



Buyer-dominated segment imposed on the supplier by the buyer/manufacturer.

FIGURE 7.6 Purchasing supplier portfolio



Supplier-dominated segment: Through its technology and marketing strategies the supplier has the customer 'locked in' a relationship.

Purchasing Portfolio

- Leverage products.
 - Products that can be obtained from various suppliers at standard quality grades.
 - The contractor has freedom of choice regarding his selection of suppliers.
- Bottleneck products
 - Can be obtained from only one supplier.
- Routine products.
 - usually have a small value per item and there are many alternative suppliers.

Four supplier strategies

- **Performance-based partnership**
 - Goal is to create a mutual participation based on pre-planned & mutually agreed cost and operational improvement targets.
 - 'Open costing' is preferred (Buyer discusses how to improve supplier's cost position. Supplier efficiency programmes developed)
 - Supply risks high.
 - Selection of supplier is important in this process.
- **Competitive bidding**
 - 'Corporate or co-ordinated approach'. Long-term contracts and annual agreements are combined with 'spot' purchasing.
 - Buyers adopt a multiple sourcing strategy
 - buying at a minimum price while maintaining quality level and continuity of supply.
 - Outsider regularly introduced to avoid price arrangements with suppliers.
 - Price changes are monitored closely.

Four supplier strategies (II)

- **Securing continuity of supply**

- Focus on this for bottleneck products at additional cost if necessary whilst looking into ways to reduce dependence on suppliers.
- Costs often outweigh gains.
- Risk analysis of most important products performed and contingency plans made (consigned stock agreements/alternative transportation).

- **Category management**

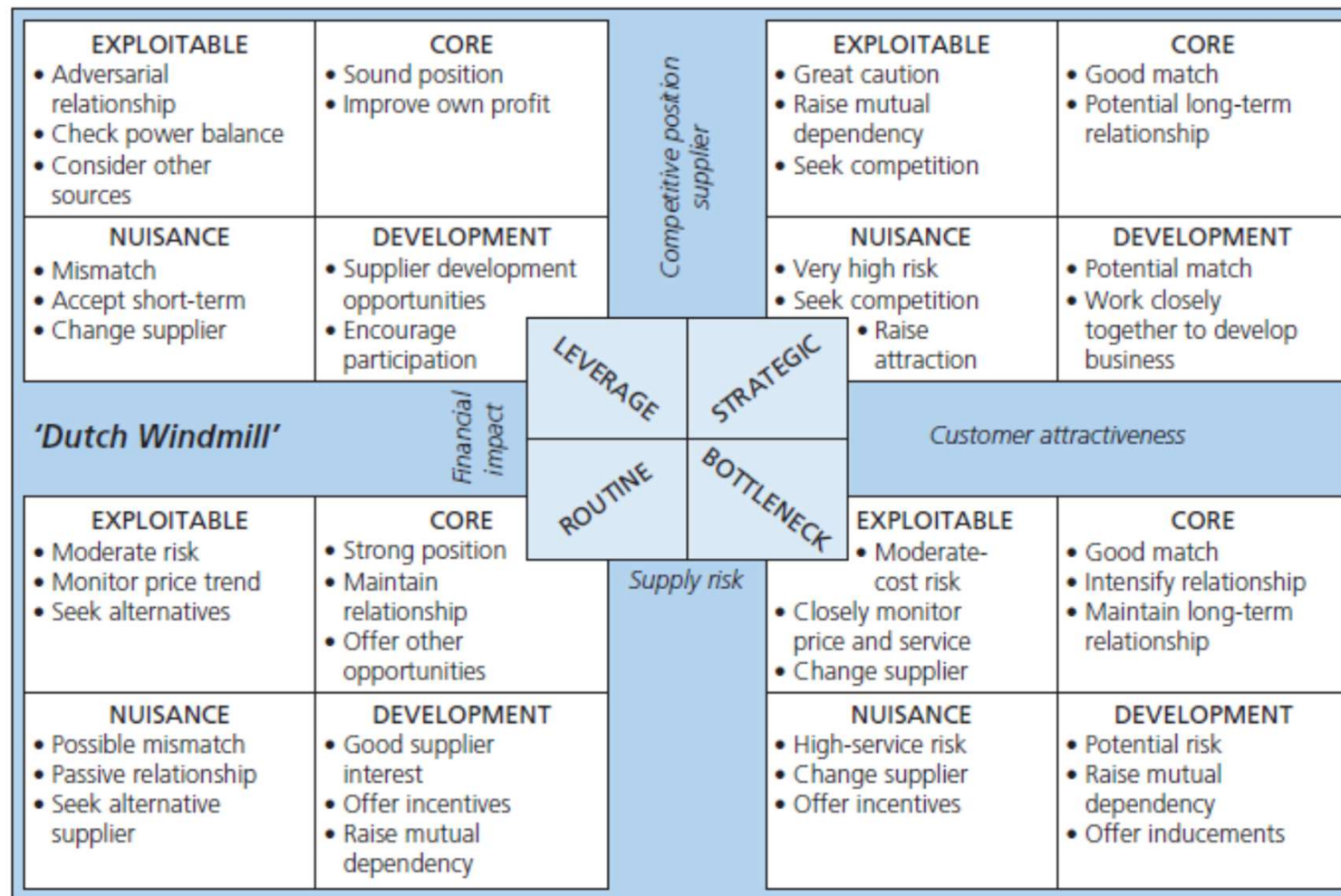
- Defined as ‘an interactive business process whereby retailers and manufacturers work together in mutual cooperation to manage categories as strategic business units within each store’.
- Routine, maintenance, repair and operating supplies (MRO) products require a purchasing strategy which is aimed at reducing administrative and logistic complexity.
- Buyers will have to work out simple but efficient ordering and administrative routines.

Table 7.2 Basic characteristics of the four supplier strategies

Strategies Characteristics	Partnership	Competitive bidding	Secure supply	Category management and e-procurement solutions
• Objective	• Create mutual commitment in long-term relationship	• Obtain 'best deal' for short term	• Secure short- and long-term supply • Reduce supply risk	• Reduce logistic complexity • Improve operational efficiency • Reduce number of suppliers
• Suitable for	• Strategic products (gearboxes, axles, optics, engines)	• Leverage products (commodities, steelplate, wire)	• Bottleneck products (natural flavors, vitamins, pigments)	• Routine products (consumables, supplies)
• Activities	• Accurate forecast of future requirements • Supply-risk analysis • Careful supplier selection • 'Should cost' analysis • Rolling materials schedules • Effective change-order procedure • Vendor rating	• Improve product/market knowledge • Search for alternative products/suppliers • Reallocate purchasing volumes over suppliers • Optimize order quantities • 'Target-pricing'	• Accurate forecast of future requirements • Supply-risk analysis • Determine ranking in supplier's client list • Develop preventative measures (buffer stock, consigned stock, transportation) • Search for alternative products/suppliers	• Subcontract per product group/product family • Standardize product assortment • Design effective internal order delivery and invoicing procedures • Delegate order handling to internal user
• Decision level	• Board level • Cross-functional approach	• Board level • Purchasing	• Purchasing • Cross-functional approach	• Purchasing • Cross-functional approach

Figure 7.7 Dutch windmill: analyzing buyer–seller interdependence

Source: Purspective (www.purspective.com). Reproduced with permission.



This portfolio approach allows the buyer to mirror his view to the one used by the supplier.

Global Sourcing

- Includes two types of activities:
 - Re-allocating purchasing volumes from domestic to international suppliers
 - Co-ordination of common items, materials and suppliers across worldwide purchasing, engineering and operating locations.
- Advantages:
 - Lower unit cost, benchmarking current suppliers, developing new suppliers to stimulate competition, access new markets.
- Disadvantages
 - Complicated distribution and logistics, increased handling costs due to customs regulations/other formalities, problems from dealing with different cultures, contractual problems, higher carbon footprint, higher uncertainty about on time delivery and quality of product.

Summary

- Concentrate on core business' because
 - Many activities can be carried out at lower cost by specialized suppliers, the company gains flexibility, and management's attention can focus on its 'core business'.
- Purchasing strategy cannot be separated from the corporate policy or from competitive strategy.
- The company needs to position against its three major groups of stakeholders, i.e. its customers, competitors and suppliers.
- Kraljic's purchasing product portfolio recognizes that different products require different supplier strategies.
 - Product groups and the supplier base are analysed (1) purchasing's impact on company profitability and (2) the degree of supply risk associated with the purchase of a specific item.
 - Further analyse the four product categories into (1) strategic products, (2) leverage products, (3) bottleneck products and (4) routine products.
- This helps explains that partnership and competitive bidding should be seen as complementary strategies rather than mutually exclusive.