

Creating corporate advantage through purchasing

Citation for published version (APA):

Weele, van, A. J., & Rozemeijer, F. A. (2007). Creating corporate advantage through purchasing. In *Proceedings of the 92nd Annual International Supply Management Conference and Educational Exhibit, May 6-9, 2007*
Institute for Supply Management.

Document status and date:

Published: 01/01/2007

Document Version:

Publisher's PDF, also known as Version of Record (includes final page, issue and volume numbers)

Please check the document version of this publication:

- A submitted manuscript is the version of the article upon submission and before peer-review. There can be important differences between the submitted version and the official published version of record. People interested in the research are advised to contact the author for the final version of the publication, or visit the DOI to the publisher's website.
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Creating Corporate Advantage Through Purchasing

Frank Rozemeijer PhD, Director
FRConsulting, Bussum, The Netherlands
+31(0)6 23092409, frank@frconsulting.nl

Arjan van Weele PhD, NEVI-Chair of Purchasing and Supply Management
Eindhoven University of Technology, Eindhoven The Netherlands
+31(0)40 24738 41, aweele@euronet.nl

92nd Annual International Supply Management Conference, May 2007

Abstract. Why do many corporate sourcing initiatives fail? In capturing corporate sourcing synergies CPO's need to manage the delicate balance between corporate synergy and decentralized business unit autonomy. This paper explains how CPO's may effectively capture purchasing synergies among individual business units. Based on our research, it will become clear that there are four important drivers for success: leadership & control, organizational and governance structure, information and communication systems and a sharp eye on the behavioral side. Further, companies need to tailor their governance structure depending on two constructs, i.e. maturity of the purchasing function and corporate coherence.

The Challenging road towards purchasing synergy. Early 2000 the Board of Directors of a French worldwide player in glass manufacturing, construction materials and performance plastics, recruited a renowned, international consulting firm to analyze their massive purchasing spend. The consultant reported impressive synergies that could be obtained from carefully orchestrated corporate sourcing initiatives among the different operating companies. As a result a coordinated corporate procurement structure was set up for contracting both direct and indirect materials. International, cross-functional sourcing teams were trained and put in place to develop detailed strategies for the strategic spend areas. Corporate agreements were negotiated with large international suppliers that in general resulted in large cost reductions. To support standardization of operational purchasing processes, major investments were made in electronic procurement platforms, enabling operating companies to get greater spend transparency and to send out their purchase orders electronically to contracted vendors. This investment should pay for itself by the procurement savings generated. However, after some time the CFO got worried. Expected savings did not show up in his records. Contract compliance appeared to be far from ideal, since most operating companies continued to favor local suppliers, putting the carefully negotiated corporate agreements aside. As a result end of year bonuses, to be paid by the corporate suppliers, were much lower than expected, influencing the bottom line results negatively. Since promises to shareholders were not met, the CFO decided to invite the CPO for a clarification of the disappointing results on corporate supplier agreements...

Does this story sound familiar to you? The good news is that you are not alone! Today many large corporations fail in their efforts to foster synergies in the area of purchasing.

Overlooking the numerous initiatives that corporations have embarked on to manage their often huge purchasing spend across their business units, the question emerges what governance structure is most effective. How to make sure that the company gets maximum value from its massive purchasing spend? Given the many disappointments in this business arena, the answer to these questions seems far from simple. Below we will explain our view on these questions.

Four different areas or pay attention to. Indeed, impressive results can be gained through concerted corporate sourcing initiatives. Provided that the proper procurement governance model is in place. Provided that the right information technology and systems are in place. Provided that the CEO and CPO have a sharp eye for the political and behavioral aspects that are related to sourcing decision-making and implementation. And, finally, provided that the CEO is able and willing to exert the right leadership in this important business arena. Let's explore each of these issues now.

Information and Communication Technology and Systems. Managing information, implementing effective international procurement information systems and building complex global procurement data warehouses are key in any corporate sourcing initiative. Apart from creating spend transparency, CPO's need their CEO to request large investment budgets for two other important IT-tools: electronic catalogue and ordering systems and e-auction facilities and marketplaces. These investments will, however, not pay off if firms are not able to build effective and coherent purchasing communities. This is one reason why some CPO's have put some part of their investment budget aside to start their own purchasing and supply chain management academies, allowing employees and managers to meet in different training programmes and roundtable settings. In order to further facilitate exchange of knowledge and experience, large companies have annual (or bi-annual) conferences for their purchasing communities. These conferences provide a platform for conveying new plans and ideas, reporting on progress, exchange between senior management and category sourcing staff and for energizing the assembled audience. In our view Procurement Intranet and Extranet solutions cannot do without this type of interpersonal exchange. It is decisive for the return that is made on any investments made in contemporary e-procurement technology.

Political and Behavioral side of synergy. Capitalizing on potential purchasing synergies across business units has also a behavioral, "soft" side. Starting up corporate initiatives implies in many cases significant changes in the way tasks, responsibilities and authorities are divided within the corporation. Implementing such initiatives, therefore, requires a careful change management approach that takes in not only logic but also emotions and hidden interests among the major stakeholders. In his or her role as an intelligent change leader, the CPO should be aware that "multiple realities" exist among key players. Issues that involve change are perceived and interpreted differently by each employee and executive. Before starting such a process, but also during it, the CPO should regularly validate and check the expectations of the most important stakeholders against his or her own expectations.

Leadership and Control. Four elements warrant interest here. Firstly, Corporate sourcing initiatives should be driven by clear targets. Although this may sound logic, it is our observation that many companies fail to provide in proper guidance of their corporate

sourcing initiatives. Secondly, having a clear target upfront, allows business leaders to free up the necessary resources. Typically, you need the best people for these initiatives and they should not be in it part-time. Thirdly, Business leaders should be reported monthly, not quarterly, on the results obtained from corporate sourcing initiatives. Finally, Corporate sourcing initiatives should be driven and actually managed by a senior executive from the board and preferably not by a Corporate Procurement Executive. Why not? Most CPO's face a difficult dilemma in that they have assumed a large responsibility for saving the company millions of euro's but at the same time lack the necessary authority and mandate. In other words: they cannot force, apart from purchasing managers in some cases, any manager in the corporation to comply with corporate agreements.

Organization and governance structure. The example at the beginning shows us what may happen if sourcing initiatives are misaligned with the company's overall governance structure. A highly decentralized organizational structure, keeping every business unit manager responsible for his bottom line results, will not coincide with a top down driven initiative. In such a situation, success can only be gained when local managers are actively engaged in the exercise. Our research has shown that companies may choose between five different governance structures when organizing for leveraged sourcing strategies. These should be carefully chosen. In the following sections we will describe the five governance models and explain how to select the right one.

Exploring Different Governance Structures. Our research has shown that companies may choose between five different governance structures when organizing for leveraged sourcing strategies. These should be carefully chosen.

1) *Centralized sourcing.* In a centralized sourcing structure all major supplier contracts are managed by a corporate center. Operating units are consulted but apart from some minor contracts, they are not responsible for key sourcing activities. Centralized procurement specialists provide the firm with a concentrated, collective sourcing and buying power. This model captures a large part of the potential corporate purchasing synergies, but users are not always involved, leading to little responsiveness to local needs.

2) *Decentralized sourcing.* Decentralized sourcing relates to a business structure where all purchases and supplier contacts are managed by individual business units. In this approach, each business unit is autonomous in its contracting activities. Cross business unit co-ordination, if any, is voluntary, ad-hoc and informal. There is no centralized co-ordination or development of policies other than what might appear through financial or other operating policies of the firm. The idea here is to minimize corporate overhead. Since business units benefit directly from cost reductions, their dealings with suppliers are usually business like. Due to the lack of coordination, however, it may appear that different business units deal with similar suppliers for similar products ending up with different prices and conditions

3) *Federal (or Local-led) Sourcing Structure.* The Federal Sourcing Structure consists of a small central core, is relatively flat in structure, and provides in a common sourcing infrastructure for all autonomous sourcing units. This infrastructure may consist of common sourcing processes, tools and templates, common IT systems and reporting and joint competence development and recruiting. Given the fact that commonality in terms of

purchased products and services and suppliers is rather limited, there are very few corporate sourcing projects. Apart from some (voluntary) coordination, most business units source for their own needs. The way in which this is done, however, is similar among the business units. Business units are encouraged to use facilities, systems, tools and services that are provided by the corporate sourcing staff. Usually, there is only a functional reporting relationship between the corporate procurement manager and the local purchasing managers.

4) *Co-ordinated sourcing structure*. This model consists of decentralized sourcing units that reside within the individual business units that are supported by a small sourcing staff at corporate headquarters. This sourcing staff oversees sourcing strategies and issues of concern for the entire firm, and it seeks sourcing opportunities for the firm as a whole, where individual business unit staff may not be able to develop this macro-view. The advantage of this procurement governance model is that the firm attains the corporate scope as well as the authority in dealing with suppliers, but it does not carry the full overhead cost that often go for fully centralized groups. This procurement model usually is to be found in corporations that operate some major global brands and that have a high degree of standardization in their manufacturing operations and product structures.

5) *Centre-Led Sourcing Network*

This governance model consists of a network in which corporate sourcing initiatives take place with the active support of fully empowered sourcing specialists from the individual business units. The corporate centre drives standardization of sourcing processes, reporting, IT-systems and competence development. The difference with coordinated sourcing is that in the coordination model no sourcing activities are conducted by staff specialists. The reason for this is that the level of expertise required for professional global sourcing resides primarily in the business units. Sourcing staff, however, may initiate corporate sourcing projects based upon specific spend analyses and supply market studies. Apart from providing governance and leadership in sourcing strategy, the primary interest of corporate staff is to facilitate networking between the individual business units to stimulate exchange of knowledge and experience. Sourcing specialists in the business units report to their own business managers but also to the CPO.

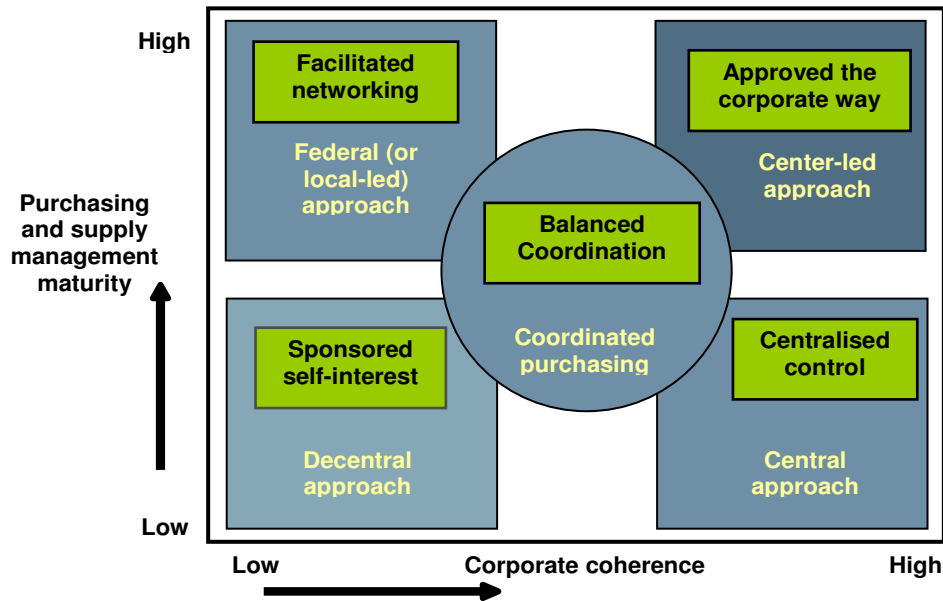
Selecting the Right Governance Structure. In our view, CPO's do not add value by choosing a certain approach to create corporate advantage in purchasing as such. They add value by creating a fit between the approach used to create corporate advantage in sourcing, and, as our research has revealed, the level of corporate coherence and purchasing maturity.

Corporate coherence is related to the extent to which the different parts of the corporation operate and are managed as one entity. Major differences across business units in management style, vision, strategy, culture and structure usually reflect a low corporate coherence. In a situation, where a firm lacks a *clear corporate strategy*, an *integrated corporate structure* and shows a *weak corporate culture*, the integration of global sourcing activities will be a significant challenge.

Purchasing maturity relates to the level of professionalism in the procurement and sourcing area as expressed in the role and position of procurement professionals,

involvement of these professionals in major business decisions, involvement of business leaders in strategic sourcing decision-making, cross-functional teamwork, the availability of company wide procurement information systems, and competence of procurement staff.

Figure 1: Governance structures for corporate procurement



Our research suggests that when the purchasing function is highly mature, companies will use a different and more advanced approach to manage corporate purchasing synergy, than in the situation where one is dealing with low purchasing maturity (see Figure 1). In cases where both purchasing maturity and corporate coherence are low, decentral purchasing is most likely to be found. In such a situation central coordination efforts will be hardly sustainable. In this situation, we expect little homogeneity in specifications across business units. However, there are opportunities to realise purchasing synergy through exchanging information of supply markets, suppliers and prices, by using voluntary working groups. In cases where both constructs are high, a center-led structure has good chances to succeed. In such a structure cross-functional/cross-business teams conduct coordination activities with active support of the business units, whilst strongly managed by a corporate purchasing staff. If both parameters have a medium value, a hybrid structure, with both central purchasing and voluntary purchasing coordination activities are most likely to be found. The central purchasing model appears to be only feasible in organizations where purchasing at the operating company level is hardly developed and corporate coherence is high.

Closing thoughts. In our experience most corporate sourcing initiatives tend to be aimed at short-term cost reductions. In many of those cases external consultants are hired to drive the corporate sourcing initiatives. However, when the consultants leave, very often companies gradually return to their old ways of working. Clearly, the model

used by the consultants was not congruent with the level of corporate coherence and purchasing maturity of these companies.

In unleashing the often-unprecedented potential of leveraged sourcing initiatives, companies need to manage the careful balance between corporate synergies and decentralized business unit autonomy. Being able to do so requires a careful selection of the right procurement governance model, selective through effective investments in information and communications technology, a sharp eye on the political and often implicit behaviour that is related to corporate sourcing initiatives and effective leadership and guidance. Only if these four dimensions have been taken care of CEO's and CPO might live up against the challenge of corporate sourcing.

Creating corporate advantage through purchasing is not about copying best practices found elsewhere. Best practices and models can inspire and give direction. But the CPO will mainly have to ensure that the selected models and working methods fit within the specific company context and management culture, and particularly within the corporate governance rules that apply. History, context, competences, ambitions and leadership will determine the most optimal solution.

Further reading

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