

*Strategic Purchasing:
A Global Perspective*

Preface

Whether we call it Purchasing, Procurement, Supply Management, Sourcing or Buying – it is evident that activities, tactics and strategies associated with such terms are of great importance to organizations. Looking at job advertisements, skilled and highly educated Purchasers and Supply Managers are in demand. Hence, academia and practice work together to further grow the function as there remain many challenges and possibilities for improvements. In line with the developments in the field, we asked 22 international MSc students to plan, write and deliver an academic book on aspects of globalization in relation to Strategic Purchasing.

We proudly present the resulting E-book of this year's project – *Strategic Purchasing: A Global Perspective*. Based on literature reviews as well as case studies and examples the students have worked on different themes with the joint ambition to describe and discuss the state of the art of Strategic Purchasing today. While the book focuses on the developments in Strategic Purchasing and Supply Management it might also provide a presentation of a coming generation of purchasing professionals.

The course and the book could not have been realized without the support of the companies and people who kindly contributed their time for guest lectures and further information: Sander Koopmans (Adjust), Hans Bax (UMCG), Ad Weterings (Gasunie) and Bauke Wierda (Koopmans).

Finally, we would like to thank all students involved. Your enthusiasm, curiosity, eagerness, cooperation and perseverance made it possible to carry out this book project (and in only 7 weeks)!

Groningen, April 2015,

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-The editorial team

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Chapter 1

INTRODUCTION

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Abstract:

This introductory chapter offers general definitions and issues regarding strategic purchasing from a global perspective. The reader is provided with an overview of the current purchasing state as well as a general understanding of the topic. First, the changing role of purchasing through the course of time is presented, followed by an introduction to globalization and its impacts. Subsequently, the purchasing process is discussed. Finishing the introduction, an outline of the book is provided, where each chapter and its topics are introduced to the reader. The book combines theory and practice with a special focus on globalization representing the golden thread throughout the storyline.

Key Words:

- **Strategic Purchasing**
- **The role of strategic purchasing**
- **Globalization**

INTRODUCTION

The changing role of purchasing

In the course of time the role and character of purchasing has been changing constantly. Traditionally, purchasing was seen as a merely supportive and supplementary operational activity, with little significance on a firm's performance. During the 1970's purchasing departments had a "more administrative than strategic" (Carter & Narasimhan, 1996, p. 21) character. It used to be a department solely handling buying orders for other divisions with its main aim to achieve maximum price reductions (Gadde & Håkansson, 1994). Even top management did not realize the importance of purchasing and its contribution to a firm's performance and regarded it as playing a passive role within the firm (Carter & Narasimhan, 1996). Economic crises such as the oil crisis in 1973 and subsequent supply disruptions supported the changing mind-set of managers. The management of external resources became increasingly important and thus, were ranked higher on a firm's agenda (Van Weele, 2014). During the 1980s a connection between organizational strategy and a company's performance was established. A previously operational and unimportant activity was now recognized as being tactical (Chen, Paulraj & Lado, 2004). Purchasing became more and more integrated and covered the involvement of purchasing in product, process, and supplier selection and contracting (Rozemeijer, 2008).

However, in the following years firms further realized the increasing importance of managing the supply base effectively and efficiently (Monczka, Handfield, Giunipero & Patterson, 2009).

Supplier networks and supplier involvement consequently emerged as important purchasing activities (Van Weele, 2014). Purchasing began to act as a key liaison between internal customers on the one hand and external suppliers on the other. It became a purchasers' task to synergize particular strengths of a supplier with a company's value proposition (Úbeda, Alsua, & Carrasco, 2015; Chen et al., 2004). In current times, owing to increased competition in a global environment firms were forced to act with more flexibility and to highlight the "focus on product innovation, time to market, and cost savings and to cater to greater customer demands" (Úbeda et al. 2015, p. 177).

The graph below summarizes the findings above and illustrates the evolution of strategic purchasing from the 1950s to the present.

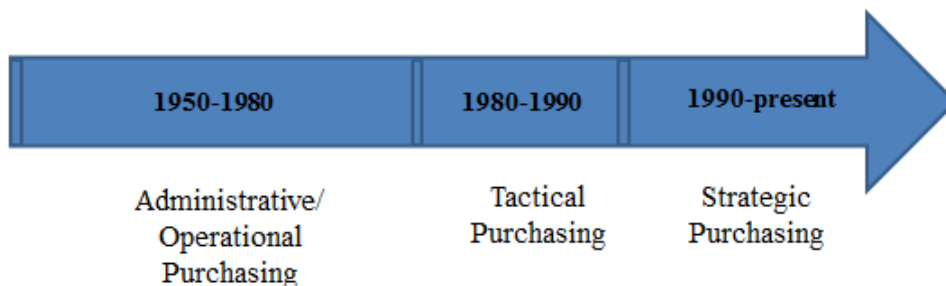


Figure 1.1 The evolution of strategic purchasing

Strategic purchasing

The evolution of purchasing makes clear that conventionally purchasing was intended to “buy the materials of the right quality, in the right quantity, from the right source delivered to the right place at the right time at the right place” (Kenneth & Lysons, 2006). This approach however conveys a rather reactive strategy of purchasing where the focus is on transactions rather than on relations and also more on a operational or tactical level rather than on a strategic one. In our book **strategic purchasing** is defined as:

The process of planning, implementing, evaluating and controlling strategic and operating purchasing decisions for directing all activities of the purchasing function toward opportunities consistent with the firm’s capabilities to achieve long term goals. (Carr, 1997, p. 201).

This definition overcomes the weaknesses of the traditional approach as it shows the reactive, strategic, relational, and long-term characteristics of strategic purchasing. It embodies purchasing as a critical driving force which does not only comprise the achievement of the cheapest price, but rather focuses on a close link to the supply base, an early supplier involvement, and the involvement of logistical activities throughout the value chain (Knoppen& Sáenz, 2015). Building relationships with the suppliers is used in order to “jointly pull costs out of the product or service” (Monczka et al., 2009, p.7) and hence reaching mutually advantageous goals (Bailey, 2008). What is more, it shows that the function goes far beyond the formerly short- term orientation of cutting costs (Knoppen& Sáenz, 2015).

Bailey (2008) identified three purchasing roles on various management levels. He distinguishes purchasing on a strategic level, on a tactical/managerial level and an operational level and applies distinctive activities and considerations to the various levels. This can be extracted from the table below. It can be seen the strategic level is long-term oriented, whereas the operational level deals with the daily business of a purchasing department.

Strategic Level	Tactical/ Managerial Level	Operational Level
Purchasing research	Buying methods	Expediting
Long range planning	Negotiations	Recods and systems maintenance
Predicting availability	Budgeting	Invoice clearance
Policy determination etc.	Contracting	Requisition handling
	Cost reduction techniques etc.	Inquiries/ quotations
		Price determinations etc.

Figure 1.2 Purchasing Roles (adapted from Bailey et al., 2008)

Globalization and strategic purchasing

After knowing more about strategic purchasing, we come to the issue which has a major influence on business strategies in general and hence also on purchasing strategies (Quintens, Pauwels, & Matthyssens, 2006).

“Globalization is the big economic event of the 1990s. It means that investors anywhere, seated at their computers and using global instant communications, can invest their money in anything -stocks, bonds, property, factories, other countries' money - almost anywhere in the world. . . Globalization promises benefits galore – jobs and prosperity for Third World countries, global markets for American and other First World companies, cheap imports for U.S. consumers, cost-cutting pressures that will force firms everywhere to be more efficient” (Chicago Tribune, 10/28/97).

This quote clearly shows how globalization has influenced the business environment during the last decades. Disappearing borders and the emergence of an international market place led to increasing competition to which companies had to adopt their strategy, especially in the field of purchasing (Monczka et al., 2009). **Globalization** is defined as:

The intensification of world-wide social relations which link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice-versa (Giddens, 1990, p. 64).

International markets offer the opportunity of saving costs on the buyer side, and on the selling side globalization provides access to new markets (Monczka et al., 2009). Hence, organizations realized that globalization and sourcing on a global level with more collaborative supplier relationships represent key strategic items in order to gain competitive advantage.

Nonetheless, there are also risks resulting from implementing a global purchasing strategy. The main issues firms are facing are the lack of skills, resistance to change, longer lead times, cultural differences, or an increased supply risk (Trent & Monczka, 2003). From these risks it can be seen that global purchasing represents a higher complexity than a domestic purchasing process, which will be explained later in this section (Trent & Monczka, 2003). Even though the process of cross-border sourcing itself does not vary essentially (Quintens et al., 2006).

The following case intends to illustrate how Windows is dealing with the increased opportunities globalization brings.

Case Study 1.1: Microsoft

With the X-box gaming console, Microsoft determined to enter the video game market. The strategic decision of outsourcing or self-manufacturing needed to be made. Due to lacking capabilities and resources Microsoft decided not to produce the product itself, but rather outsource the assembly and logistics function to Flextronics. A company which is based in Singapore and Microsoft was collaborating successfully with before. Microsoft was focusing on a partner that was low in price, but at the same time offering a high quality and react quickly to shifting demands.

Flextronic followed an industrial park strategy, which made it possible to tightly manage its supply chain, whereby costs were reduced and supply disruptions were mitigated. This strategy asked Flextronics key supplier to build up plants close to the assembly line at low cost locations close by the end market. During the initial phase, the X-box was produced in Hungary, for the European market and Mexico, for the American and Asian market. After one year however, the production was moved to China, as the labor costs were much lower. Microsoft and Flextronic worked together for many years and established a close supplier relationship, which helped to stabilize the business transaction. While some Flextronics employees are working at the Microsoft headquarter, some Microsoft people are located at Flextronics.

(Jain & Swarup, 2011)

This case highlights the global orientation firms have and the increasing opportunities an international market offers. It shows the motivation of organizations to act globally and the impact the purchasing department has on the overall performance of a firm, a topic that will be discussed in chapter two in more detail. What is more, the increasing importance of the relational aspect with the inherent changing attitude towards suppliers is illustrated here.

Despite the increasing recognition of global purchasing, some fields of research are still uncovered. For example, literature is lacking the investigation of consequences of global purchasing at the functional level or on the other hand the correlation of the intensity of global purchasing and the effectiveness of the overall firm (Quintens et al., 2006).

Strategic purchasing process

The purchasing process separates distinctive elements and activities. During the last years much research was done in the field of purchasing and as a consequence, many different kind of models emerged. Generally, these models are all based on distinctive activities within the purchasing process. However, there are differences in the denomination as well as the grouping of the particular elements in the various models. Some models describe 4 different stages, whereas others examine more. Woodside and Samuel (1981) for instance identified four phases of a purchasing process: developing and analyzing requirements, preparing request for quotations (RFQ) and analyzing quotations, committee-supplier negotiations and lastly post - negotiation evaluation and reporting. The number of four stages however, is too

little, as it does not give enough description of the phases. That is why Van Weeles' process model which describes six stages will be the fundament of the book and will be explained in the further description. The model shows the interconnectedness of the activities, meaning that the output of one stage has an impact on the input of the subsequent stage. For example, an insufficient specification of the requirements can lead to a poor quality of goods that does not meet the requirements of internal customers. The model itself is intended to help managers to structure the purchasing process in decision making as well as operations (Van Weele, 2010).

Specification Phase

During the first phase the internal customer specifies the requirements for the focal product or service which are needed. Naturally two distinct types of specification are separated: detailed (technical) and functional specification. The former is used to set up detailed characteristics of the good being it technical pre-settings or supplier's activities. Functional specifications describe the range of capabilities the purchase needs to have rather than a detailed prescribed approach. This has some advantages. First, the supplier being an expert in his field, can decide about the best achievable solution without being restricted by the buyer. Which leads directly to the second point, innovation is encouraged (Johnsen, Howard, & Miemczyk, 2014). It is important that specifications embody the needs of the whole business organization. Thus, need to express the requirements of both internal customers and end customers (Johnsen et al., 2014). If the specifications are not made properly due to a lack of communication with internal customers, the response of the prospective supplier will present an inappropriate offer in return (Rees, 2011).

Selecting Phase

After stipulating the specifications the selection process can be started. Mainly, it is about searching for a range of prospective suppliers in the market fulfilling the basic requirements. Subsequently, the number of suppliers is diminished bit by bit until the best fitting partner in terms of quality, cost, terms, delivery, service, and experienced performance on previous orders is identified (Johnsen, et al., 2014).

Contractingphase

Contracts set the legal framework of the buyer supplier relationship by which contractual trust is established between the participating parties. Contracts represent the first stage of a successful new purchasing relationship and help to avoid and regulate the hazard of non-compliance. Main clauses that are mainly included are price and terms of delivery, terms of payment, warranty conditions and penalty clauses (Johnsen, et al., 2014). Contracting represents an important element in the purchasing process. It is not only about signing the contract but rather additional effort is needed to manage the contracts. That is why chapter four is going to elaborate this topic in more depth.

Ordering and Expediting Phase

Following that, ordering takes place. Incrementally by means of electronic software, which supports the automation of the ordering process hence, transaction costs are decreasing due to less time exposure (Johnsen, et al., 2014). The purchaser specifies the purchase information such as an order number, delivery time, unit price and volume of ordered units, delivery address and invoice address. Once the supplier received it, he usually sends a confirmation in order to approve the order (Johnsen, et al., 2014; van Weele, 2010). Expediting implies that the process is monitored. The aim is to guarantee that the ordered goods are delivered in the right quality within the time stipulated, with the right and appropriated packaging and last but not least, at the right location (Johnsen, et al., 2014)

Evaluating Phase

The final state represents the evaluation. Not only does the suppliers' performance need to be followed up but also the performance of the product that was delivered. This implies penalty clauses, warranty claims, invoice administration, but also positive actions can be considered here in order to keep the suppliers motivated (van Weele, 2010, Johnsen, et al., 2014).

The purchasing process as explained above and illustrated in the figure does not take place in each and every purchase situation. It merely displays a first-time purchase with a high degree of risk, uncertainty and novelty. Regarding efficiency and effectiveness straight repurchases and modified repurchases normally do not need to walk through the entire process again (Johnsen, et al., 2014)

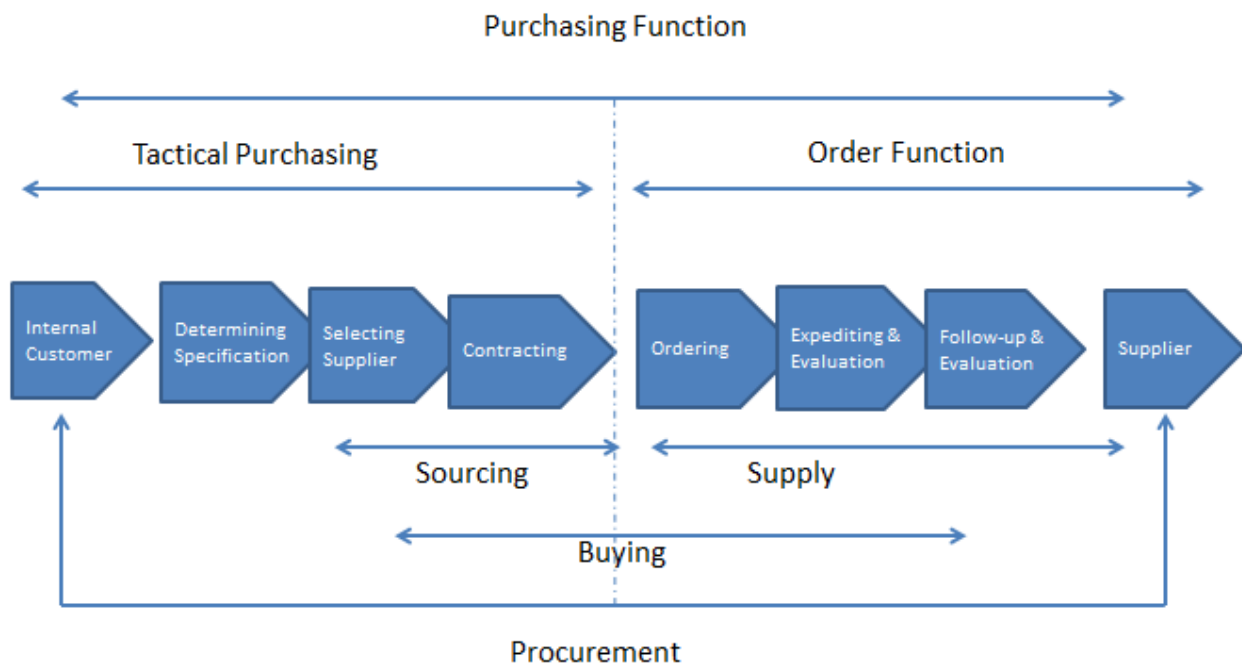


Figure 1.4 Purchasing Process Model (adapted from Van Weele, 2010)

Construction of the book

This section is intended to give the reader an overview of the set-up of the book itself as well as the main content of the various chapters. Each chapter starts with an abstract, which defines the main points discussed. In order to facilitate the reading, keywords are also given in the first page. After a short introduction, the theory part begins including case studies which are related to the topic discussed. The purpose of these case studies is to link theory and practice while also providing the reader with examples in order to develop a better understanding of the topic and to experience the purchasing aspects in “real-life”. At the end of each chapter the main findings and key topics are summarized in a conclusion. The reader is also provided a glossary, which helps in finding the definition of a keyword and ensures the understanding of the concept elaborated in the chapter. Every time a new definition is given for the first time, it will be printed in **bold**. This illustrates that the definition can be found in the glossary at the end of the book sorted in alphabetical order.

Future of purchasing

The role of purchasing is constantly changing, as examined previously. Each period constituted something special to the development of strategic purchasing. As business environments are characterized by their dynamic nature, firms will be further challenged to adapt to these constant changes and to cope with them in an efficient way (Zheng, Knight, Harland, Humby, James, 2007). For that reason this book elaborates future trends of strategic purchasing in each chapter by means of a future box at the end of each chapter.

Content

This book presents the reader a walk-through of Van Weeles’ Purchasing Process as explained above. In the following chapters one is given the chance to have a deeper look inside this process. The following graph shows the content of the book, applied to the purchasing process of Van Weele.

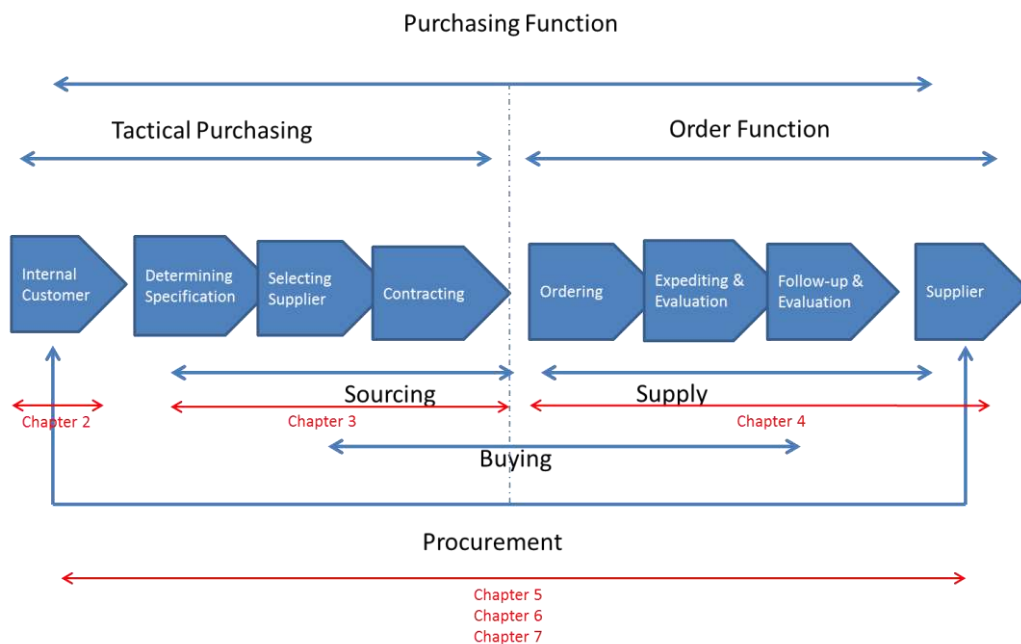


Figure 1.5 Construction of the book based on the process model of Van Weele (2010)

After discussing the basics about strategic purchasing and globalization by means of Van Weeles purchasing process and a case study, the reader is ready to go into more depth in the following chapters.

Chapter 2: Internal Aspects

As the first chapter provided a first insight to the overall content, the second chapter will focus on the internal alignment of purchasing strategies. Both vertical alignment, meaning the alignment of functional strategies with corporate strategies, and horizontal alignment between the different departments are discussed here. After reading chapter two, the reader will be able to understand the correlation between organizational structures, the purchasing function and purchasing strategies. What is more, the reader is shown the integration of the purchasing department through cross-functional teams and highlights its advantages and drawbacks.

Chapter 3: Sourcing Strategies

Chapter two combined the internal alignment with organizational structure and thus offers the basis for the third chapter, which will highlight different sourcing strategies. Additionally, internal customer relationships, different theories such as transaction cost theory, cost and product leadership, and the Kraljic model are examined. After reading this chapter, the reader knows about different sourcing strategies and is familiar with certain advantages and disadvantages resulting from these strategies.

Chapter 4: Supplier Relations and Contract Management

Since the third chapter focused on the sourcing strategies, the fourth chapter will go one step further in the purchasing process and emphasizes relationship management. It will discuss supplier relations and contract management. After reading chapter four the reader gains knowledge about the importance of supplier-buyer relationships, the consequences of not having a proper relationship, and how contracts are involved in this topic.

Chapter 5: Purchasing Professionalism

The fifth chapter deals with the specific skills of a purchasing department. Also the development of skills and the influence of skills on the purchasing profession are considered and applied to a global context. At the end of the chapter the reader knows about the dynamic skills and professions of a purchasing department, and how these are influenced by globalization.

Chapter 6: Service Purchasing

Chapter six offers an insight to a specific field of purchasing. The procurement of services will be discussed. Here the process of buying goods will be compared to the process of buying services and the differences are elaborated. After reading this chapter, the reader will know that there are certain differences in buying services and how certain difficulties can be overcome.

Chapter 7: Sustainability

The last chapter deals with a topic which is of increasing importance for purchasing departments: sustainability. Here definitions, principles and issues regarding sustainability are given and a link between sustainability and the purchasing department is made. At the end of this final chapter, the reader is aware of the rising importance of sustainable purchasing and the impact sustainability has on firm performance.

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Chapter 2

INTERNAL ASPECTS

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Abstract:

The aim of this chapter is to clarify and discuss internal aspects, such as procedures as well as decisions and strategic alignments that build the basis for any decisions that are made throughout the purchasing process. This chapter evaluates in the first part the vertical alignment of organizational strategies and discusses the strategic alignments. The second part deals with the horizontal alignment and clarifies the horizontal integration and within that, the role of purchasing. Moreover, the key drivers as well as barriers to horizontal alignment as well as purchasing involvement are presented.

Key Words:

- **Vertical internal alignment**
- **Horizontal internal alignment**
- **Organizational strategy**
- **Strategic alignment**
- **Organizational performance**

INTRODUCTION

“While today's globally operating firms have redefined their production and marketing strategies accordingly, they more or less failed to do so with respect to their cross-border purchasing strategy and activities (Kotabe & Murray, 2004; Trent & Monczka, 2002)” (Quintens, Pauwels & Matthyssens, 2006, p.881). Purchasing is considered a strategic function with the highest long-term profitability impact, however it has only recently been covered as a critical issue in research. Global purchasing strategy (GPS) or otherwise called: Global purchasing is internal to the company and should not be mistaken with an external perspective that focuses on the supplier, product or market (Quintens et al., 2006). “GPS refers to the organizational alignment of the purchasing function, not the way purchasing is executed”(Quintens et al., 2006, p.882).

According to Kotabe and Murray (2004) as well as Trent and Monczka (2002) in Quintens et al., 2006), it becomes clear that the strategic alignment is an important issue when considering purchasing strategies. This is the case because “strategic purchasing supports [the] overall corporate strategy in its market and value proposition through its proactive and long-term management of the firm’s supplier relationships” (Knoppen & Sáenz, 2015, p.125). The internal aspect of strategic purchasing mainly considers the internal alignment of the departments. **Internal alignment** is defined as “the set of commitments, strategies, policies, systems and behaviors that support integrated customer decision making based on suppliers’ commercial and ethical commitment and performance” (Sisco & Wong, 2008, p.5). Therefore, both the vertical and the horizontal internal alignment are important to consider. Vertical internal alignment means the alignment of functional strategies with corporate strategies. Horizontal internal alignment however, deals with the alignment across the different departments.

Internal alignment, independent of the horizontal or vertical alignment has four different aspects. According to Sisco and Wong (2008) the first aspect of internal alignment requires the executive commitment, which means that the corporate culture needs to communicate common goals and behaviors. The second aspect considers integrated policies, strategy and structure (Sisco & Wong, 2008). Corporate wide it needs to be clearly communicated how products are purchased. Products can be purchased either central, de-central or as a combination of both which is called hybrid, the following chapters will go into depth in the decision making of the way of purchasing. Moreover, the make or buy decision referred to as a strategic decision that has both implications for the internal purchasing strategy as well as the overall corporate strategy of the organization (McIvor & Humphreys, 1997). Communication is a large part of the internal alignment; for this reasons the consistent internal communication is the third aspect that requires consideration (Rapert, Velliquette & Garretson, 2002). For example, if a corporation chooses for decentralized purchasing, a consistent communication is required (Monczka, Handfield, Giunipero & Patterson, 2009). As a fourth aspect, the reporting and information needs to be thought of, and questions need to be answered whether information will be centralized or whether the internal alignment needs to be evaluated for example through cross functional evaluation (Sisco & Wong, 2008).

This chapter will be divided into two main parts, in the first part the vertical internal alignment will be discussed and the second part deals with the horizontal internal alignment. The reason for this can be demonstrated in figure one below.

To effectively discuss the vertical internal alignment, different frameworks such as Porters' generic strategies, product leadership and operational excellence theories will be compared and evaluated. Furthermore, the link between the corporate strategy and the purchasing strategy will be drawn, by aligning the objectives of the strategies and identifying how the purchasing strategy complements or differs from the corporate strategy. Furthermore, the internal advantages and disadvantages as well as challenges for the purchasing department will be discussed regarding the Make or Buy decision. However, in this chapter the focus will not be on how Make or Buy decision is made, instead the focus lies on the internal reasons behind it. Moreover, the internal effects of a centralized, decentralized or hybrid purchasing structure will be evaluated in this chapter as well. In the second part of this chapter the horizontal internal alignment will be discussed. Which deals with alignment of different departments into the purchasing process. Thereby, cross-functional teams as well as communication will be discussed as an option for aligning the departments. The value chain with different departmental objectives will assist in defining the different scopes of the departments, as well as the balanced scorecard. Furthermore, barriers to horizontal integration will be evaluated and discussed, the author will come up with an overview of barriers and example cases to clarify the barriers and put them into practice. Lastly the issue of Maverick Buying will be discussed by using multiple cases.

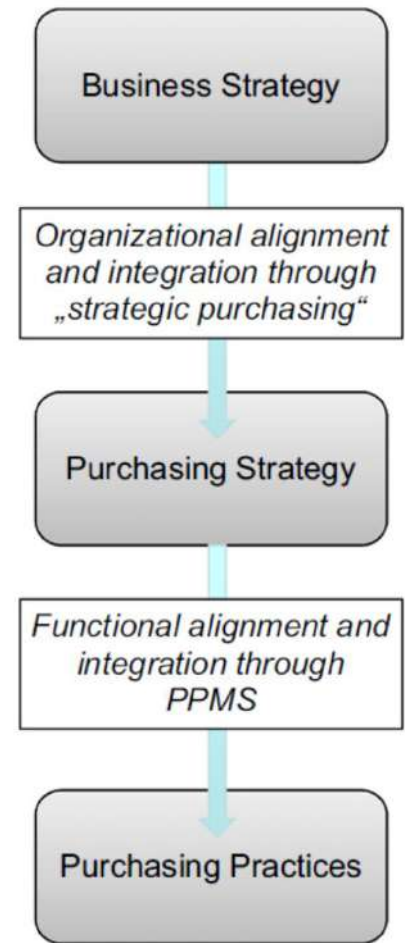


Figure 2.1: Internal Alignment
(Pohl & Foerstl, 2011)

The chapter will end with a conclusion of the most important findings and give the reader several future implications and areas where further research could be conducted in.

VERTICAL INTERNAL ALIGNMENT

The vertical internal alignment refers to the top-down alignment within an organization. Top-down alignment in this sense means that it deals with the alignment of strategies as well as the influence of decisions on the purchasing department. In the following part different organizational strategies will be evaluated and combined to receive an up-to-date view on organizational strategies. This understanding of organizational strategies will assist further in the understanding of the alignment of strategies. The case of Volkswagen (see case study 2.2) will provide the necessary insights from practice to provide a comprehensive understanding of the strategic alignment. After having clarified the importance of aligning strategies, the influence of certain strategic decisions in the purchasing department will be analyzed.

Organizational strategies

When looking at organizational strategies in this part of the chapter a basic, but sometimes referred to as an outdated model, Porter's Generic Strategies Framework is used for general understanding. It is used to define different strategies and their roles within the organization. In order to build on Porter's framework, product leadership and operational excellence have extended it. Porter's generic strategies framework consists of four strategies. The first part is the 'cost leadership'. This strategy allows firms to stay profitable while the competitors make losses (Clegg, Carter, Kornberger & Schweitzer, 2011). When following the cost advantage strategy, the purchasing department is required to reduce costs as much as possible and continuously exploit cost advantages. Furthermore, this allows the purchasing department to increase corporate profits, as well as to ensure a cost efficient production. The advantages of cost leadership are the access to capital, which allows for investments while competitors face difficulties. This also creates entry barriers to competitors that try to enter the market. The second part of Porter's model is the 'differentiation strategy'. According to Clegg et al. (2011), the differentiation strategy explains that the product is unique and stands out from other similar products. In general this means that the firm tries to deliver valuable products in the changing environment and changing market conditions. The differentiation strategy focuses on building a sustainable competitive advantage by designing a unique product that is difficult for competitors to imitate (Clegg et al., 2011). In this case the purchasing department takes the role of exploitation of the market in terms of exclusive and high quality products as well as continuous innovation that assists in developing long-term supplier relations. Internally, this leads to a high demand in the alignment of the R&D, marketing as well as production department with the purchasing department, to further develop new opportunities. The reason for this is that the purchasing department can be seen as an internal supplier to its internal customers (Wisner & Stanley, 1999).

The third and the fourth part of the framework can be summarized to 'focus'. This means that the company will focus on a niche market. Within the niche market the organization can choose to either follow the strategy of cost leadership or the differentiation strategy (Clegg et al., 2011).

In the book 'The discipline of market leaders' from 1997, Treacy and Wiersema described three further strategies that complement the generic strategies of Porter. Treacy and Wiersema (1997) explain these strategies as operational excellence, customer intimacy and product leadership. "Operational excellence is a philosophy of leadership, teamwork, and problem solving resulting in continuous improvement throughout the organization by focusing on the needs of the customer, empowering employees, and optimizing existing activities in the process (Liker, 2004)" (Charisis, Vrellas & Tsiotrad, 2014, p.31). The operational excellence strategy can be used to extent the cost leadership strategy of Porter, as the aim of operational excellence is cost leadership. However, the main focus in this strategy is on the automation of processes and not, compared to the model of Porter, the movement to more cost efficient areas. Operational excellence theory therefore, focuses on transaction-focused and standardized production. Leading organizations in the area of operational excellence are mostly centralized firms (Treacy & Wiersema, 1997). This means that when the organization follows an operational excellence strategy the purchasing department has to focus on operational purchasing and not on the desired strategic purchasing. Companies that follow the product leadership strategy want to create superior products and introduce uniqueness to the markets. Market prices therefore, tend to be in the premium range (Treacy & Wiersema, 1997). One example of product leadership strategy is Apple Inc. Apple managed to reshape the mobile phone as well as the portable computer markets by

introducing iPhones or Macs (Apple Inc., 2015). When Apple Inc. introduced these devices on the market, competitors such as Nokia were left behind and had difficulties in regaining market share (McCray, Gonzalez & Darling, 2011). Due to continuous innovations, Apple

Case Study 2.1: Apple Inc.

Apple Inc. was founded in 1977, and became the leader in computer industry after Steve Jobs became CEO in the late 1990s. Apple Inc. produces both, software and hardware. The organization has a strong reputation in computer and consumer industry, with a strong focus on the marketing and design of its products. Due to this product leadership focus, production of main parts and components has been outsourced to Asian countries. Next to the headquarter in Cupertino, Apple Inc. owns only one other facility in Ireland. NGO's such as Greenpeace pushed Apple Inc. into a more sustainable business approach. After these claims, Apple published reports on changes and achievements. For the purchasing strategy this meant to not only focus on cost efficiency and operational excellence but also on sustainable supplier sourcing. Since then, Apple aligns its practices to a more sustainable focus and ensures the usage of these practices through regular audits and training programs to assist in supplier comply, which will be further discussed in Chapter 7 of this book (Kumar, Teichman & Timpornagel, 2012).

(Apple Inc., 2015)

Inc. is able to ask superior prices for their products (Nonala & Kenney, 1991).

Firms that follow the product leadership see teamwork and problem solving as key to their success (Treacy & Wiersema, 1997). The customer intimacy strategy can be compared to Porter's focus strategy. Customer intimacy focuses in offering a unique set of products and services that allows the organization to customize their products (Treacy & Wiersema, 1997). The aim of this strategy is to meet different customer needs. While Porter only concentrates on the area where a potential firm could be involved in and then divides only between cost leadership and product differentiation, Treacy and Wiersema (1997) point out in their book that the strategy of customer intimacy is more about creating a network with suppliers and extensive knowledge about customer needs. According to the authors, true customer intimacy can only be achieved by aligning the product development, manufacturing, as well as administrative and executive functions such as purchasing. Organizations that follow the strategy of customer intimacy most likely tend to be decentralized organizations, as the structure allows for fast learning and adaptation (Treacy and Wiersema, 1997).

To conclude, every organization follows a different strategy. The strategy it follows is the basis for decisions and strategies within departments. The next part will deal with the alignment of these strategies.

Aligning strategies

The organizational strategies discussed in the previous sections are the basis for the purchasing strategy and therefore, the purchasing strategy needs to be aligned with the organizational strategy. This is the case because each of the organizational strategies includes a different management and investment approach referring to resources, planning or

personnel skills (Miles, Snow, Meyer, & Coleman, 1978). However, according to Miles et al. (1978), the internal responsibility of the purchasing department is to combine the different choices of external resources. The alignment of the organizational strategies to the departmental strategies as of purchasing strategies can be achieved in a vertical setting through, for example, the mission or vision statement as well as corporate values (Borella & Padula, 2010). According to Williams (2008), the mission statement in general defines the customers and the products or services the customers will be provided with. Furthermore, according to Barts, Bontis and Taggar (2001), the mission statement plays a key role in aligning the corporate strategies as well as there exists a moderating effect of the mission statement on firm performance. The vision statement takes the scope a bit further and focuses on the long-term goals of the firm (Quigley, 1994). While the corporate values influence all corporate activities both internally and externally.

The mission, vision and corporate values build the center of each organization and assist in ensuring to align different strategies. For example if the mission statement states to provide the highest quality, the purchasing department strategy needs to make sure that the focus is on quality and not on price.

Case Study 2.2: Volkswagen AG

The Volkswagen Group (VW Group), one of the largest automotive companies in the world, does not write a corporate mission or vision statement, the group defines strategies and goals for a time period of about five years. On Volkswagen's homepage the 'Group Strategy 2018' can be found that was written in 2013, and which defines four key aims of the group for these five years. The first one is "to develop technologies to become a world leader in customer satisfaction and quality" (Volkswagen Aktiengesellschaft, 2013). The following three goals include "increase unit sales", "long-term return on sales [...] of 8% to ensure the Group's solid financial position" and "to be the most attractive employer in the automotive industry" (Volkswagen Aktiengesellschaft, 2013). After defining the goals, the corporation also gives directions on how to achieve the goals, for example the VW Group stresses out to concentrate on environmentally friendly actions. These four aims and the following guideline on how to achieve these aims are the fundament of the strategies of all departments. In this case, for example, the purchasing function supports the corporate strategy by concentrating on a continuous development of technologies with the help of the sourcing strategy. Furthermore, the purchasing department is asked to concentrate on sustainable and environmentally friendly product parts for the manufacturing department. By following this strategy, the purchasing department allows the corporation to increase the brand image in society as well as to strengthen their market position. This can be supported by the research of Kumper, Teichman and Timpernagel (2012), who state in their study that profitability can only be achieved through sustainable strategies. Therefore, the purchasing department adds value to the corporation by aligning their management approaches to the overall strategy.

(Volkswagen Aktiengesellschaft, 2013)

Volkswagens way of aligning strategies, namely by goals and objectives, is another opportunity for a firm to align organizational strategies. Both, goals and objectives specify the firm's targets the firm wants to achieve. These targets also need to be made available to everyone within the organization. However, the firm cannot only provide goals and objectives. After communicating the goals and objectives, the firm should present a plan on how to achieve them, just as mentioned above in the Volkswagen example (Volkswagen Aktiengesellschaft, 2013; Lawler III, 1990).

To conclude, the research states that strategic alignment can be achieved by defining a clear mission or vision statement for the corporation, which takes the role of guiding the departments in clarifying the individual strategies of the departments. However, most small and medium sized companies do not publish such statements, even though they are a good way to give an organization a direction and therefore this does not apply to all firms. Since this book is book its main focus is purchasing in globalization it applies to most of the readers alignment problems.

Due to the outcomes above, the actual meaning of strategic alignment can therefore be summarized, as two strategies that do not work against each other but instead follow the same principles and complement each other.

'Make or buy' – decision

After the organization has decided for a corporate strategy, which has been aligned to the purchasing strategy through mission or vision statements, the organization needs to decide whether they 'make or buy'. The question whether to make or buy basically means that the company needs to clarify their core competencies and decide what portion of their business they want to make and which parts they should buy. In this Chapter of the book it will not be discussed how to outsource (buy) or vertically integrate (make) and what the advantages are of each; instead, the concentration has been put on the internal effects of this decision. First the role of purchasing internally will be clarified when deciding to make or to buy. After that, different internal roles and reasons of having a centralized, decentralized or hybrid way of purchasing will be evaluated.

According to Klein, Crawford and Alchain (1978) and Pisano (1991) as well as McGuire and Staelin (1983), vertical integration is the degree to which a firm owns the subsidiaries that provide products or services to the final product. A vertically integrated firm is engaged in different parts of the production such as manufacturing, marketing or transporting. According to the authors, three different types of vertical integration exist. The first one is the so called 'backward vertical integration', which means that the firm owns or controls the subsidiaries that produce parts of the final product. By controlling these subsidiaries, the firm ensures a consistent supply and quality. 'Forward vertical integration' is the second way of vertical integration. The forward vertical integration means that the firm controls distribution centers and retailers. A third type is the combination of the forward and backward integration.

According to Burt, Dobler and Starling (2003) products or services should only be outsourced if they are not critical to success, do not need specialist skills and do not fit into the core competencies of the firm. According to Burt et al. (2003) items that fulfill one of these issues can be seen as strategic items. Therefore, the strategic purchasing department needs to be aware of managing their internal core competencies. Furthermore, an effective

implementation and optimization of the strategic items needs to be ensured, to be able to assist the organization in achieving a competitive advantage.

From a strategic point of view, according to De Fontenay and Gans (2008), outsourcing mirrors a strategic issue, as it includes the changing ownership of the resources and assets that are outsourced, to another firm, which needs to be managed through long-term contracts. However, this needs to be managed by the sourcing strategies (see Chapter 3) as well as the contract management (see Chapter 4). However, if the organization decides to outsource, the purchasing department can save for example costs by deciding on the right sourcing strategy, which will be elaborated more closely in the next chapter. Moreover, if a firm outsources, the flexibility for example in low market development phases is higher than if the company integrates the area (De Fontenay & Gans, 2008).

Case Study 2.3: Insourcing/Outsourcing FlexCon

Generally spoken the consideration of insourcing and outsourcing decisions contains a detailed analysis of a company's competencies, costs, technology and quality. The case of the company FlexCon, which is a producer of small industrial engines represents internal decision that need to be made. FlexCon is restructuring itself and needs to decide where to focus its strategic investments on. The top management is of the opinion that too many people work on the production of "simple" products that do not lead to competitive advantage. So far, in order to secure jobs the company outsourced all complex and challenging manufacturing parts and insourced the simple ones. This has lead to a major dependency on the suppliers for such complex components, which caused lower performance of FlexCon and increased costs for the ready products. Out of this reason, the organization has gone through a major strategic change where all departments have been involved, including for instance purchasing, marketing and R&D. FlexCon has been advised, due to rapid market changes, to use computer simulation tools which allows for comparison of different sourcing opportunities. This allowed the company to receive more confidence in concentrating on strategic items and finally the firm has been able to outsource its product group that contains a rather non-strategic character.

(Monczka, Handfield, Giunipero & Patterson, 2009)

Linking back to the alignment of strategies, a firm that chooses for outsourcing needs to make sure that the suppliers also act according to the strategies of the firm. As in the example of Volkswagen, where the organization defined that they want to focus on environmentally friendly production and products, Volkswagen needs to make sure to control that the suppliers they are sourcing from also produce environmentally friendly. Nevertheless, the purchasing department supplies the internal customer and therefore, some parts are for example required to be purchased on short-notice or in line with corporate strategy, such as when the corporation decided to focus on local products. Depending on that, the organization needs to decide whether to purchase centralized or decentralized, which will be elaborated more closely in the next part.

Centralized or decentralized purchasing

After having decided whether to make or buy certain parts of a product or service, organizations need to clarify their structure depending on the corporate strategy. For example in terms of whether the purchasing department will be centralized, decentralized or a combination of both, hybrid.

According to Hu (2004), centralized purchasing means that the headquarters will purchase all products for the organization. Internally, this centralized structure allows for more control and efficiency in the usage of products and inventory (Hu, 2004). Furthermore lower costs of labor occur. However, due to a centralized purchasing department, the transportation cost could increase especially in a global organization where distances play a key role whereby it is more difficult to react on short-notice orders (Hu, 2004). Moreover, it is harder to react on external influences from another country; it will take longer for the organization to adapt (Hu, 2004). Furthermore, a centralized purchasing department requires well-established communication lines between the departments to avoid for example maverick buying (Monczka, Handfield, Giunipero & Patterson, 2009). This, however, will be further explained in the second part of this chapter.

In case of decentralized purchasing, where, for instance, every subsidiary purchases on its own, the efficiency is lower, due to the fact that some parts will be needed in every subsidiary, and centralized purchasing proves to be cheaper. However, the transportation cost and risk will be lower (Gelderman & Semeijn, 2006). Furthermore, local purchasing departments can look for so-called Local Heroes. Local Heroes are firms and brands, which have a high reputation and high market-share in one region but are not present in the global market (Heimeshoff & Klein, 2014). These firms would not be taken into consideration by a centralized purchasing department.

As already mentioned in the introduction, recent literature points out the advantages of hybrid purchasing. Hybrid purchasing refers to the fact that some parts are purchased centrally and others decentral. According to Faes, Matthyssens and Vandembemt (2000) as well as Matthyssens and Faes (1997) (as cited in Trautmann, Bals and Hartmann, 2009), a main issue in hybrid purchasing is to decide, which items to purchase centralized and, which items should be purchased by each subsidiary (decentralized). One strategic internal choice can be the category management, which will be elaborated in the second part of this chapter.

To summarize this first part of chapter two it can be said that the most important internal aspect, identified so far, is the alignment of the strategies with the help of mission and vision statements as explained in the section *Aligning strategies*. Furthermore, the impression rose, that communication and lines of reporting are central to the success of the strategic alignments and therefore, it will be more elaborated on in the second part of this chapter.

The second part of this chapter will deal with the value chain within the purchasing department as well as the alignment of different departments horizontally.

HORIZONTAL INTERNAL ALIGNMENT

After having discussed the vertical alignment of strategies within the organization, horizontal internal alignment deals with the alignment between the departments. This part discusses the role of purchasing within the organization as well as organizational performance and

purchasing. Additionally, barriers and risks of the internal alignment of the purchasing department will be discussed and finally the issue of maverick buying will be thoroughly investigated.

Introduction to the value chain and the position of the purchasing department

Adding more value to customers in such a way that a competitive advantage can be gained, is the goal of almost every organization. How departments are able to add value to the organization can be seen in Porter's value chain. Instead of describing an organization in departments, Porter takes a process view of the firm: the value chain (Figure 2). In 1985, Porter describes organizations in terms of the primary and support activities that are performed to create, deliver, and support a product or service. The primary activities of inbound logistics, operations, outbound logistics, marketing and sales, and service are chained together in sequences that describe how an organization transforms its raw materials into value-creating products. "The value chain is supported by common activities, shared across all the primary activities" (Porter, 1985 as cited in Pearlson & Saunders, 2009, p. 57).

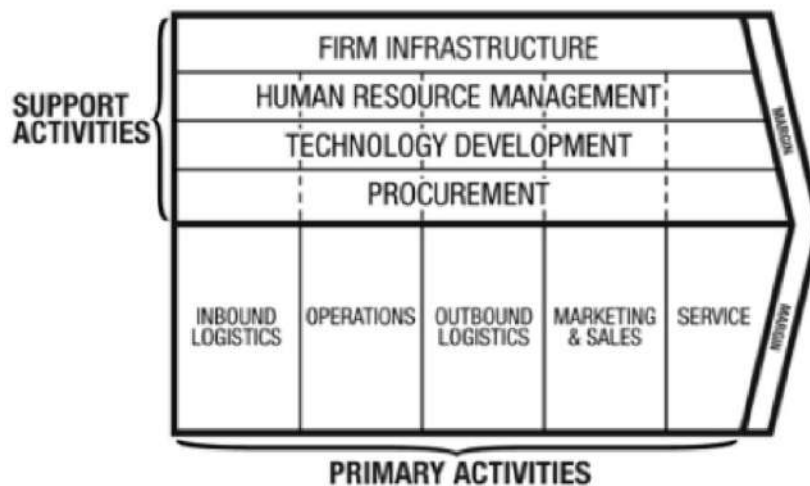


Figure 2.2: Value chain (Porter, 1985)

These primary and supporting activities can be seen as the building blocks to gain competitive advantage. However, it is not a set of independent activities but a system of interdependent activities (Pearlson & Saunders, 2009). According to the value chain, the purchasing department has a supporting function, as it can have an important role in each primary activity. The purchasing department could for example, support operations with certain activities, which will be more closely investigated throughout this chapter. The value activities are related within the value chain by so-called linkages. These linkages can be described as relationships between the performance of one activity and the performance of another (Pearlson & Saunders, 2009). Therefore, as the activities are interdependent these should be horizontally aligned with each other, which will be discussed in the next section. To receive a more practical view on the changing role of purchasing within the value chain the following case study will offer insights.

Case Study 2.4: a critical role of purchasing at Manitowoc

The importance of the purchasing department for the rest of the company is well illustrated in the case of Manitowoc. When the purchasing department is not able to buy the raw materials for production, or the parts for assembly the production department cannot do any work and the customers will not be satisfied.

Once lowly bureaucrats, purchasing managers are shifting onto the front lines. Robert Ward is one of them and is in charge of purchasing for Manitowoc Co., one of the world's biggest crane makers. His job is to ensure an unbroken flow of parts and materials from around the globe, hunting industrial tires in China and scouring the Midwest for giant bearings. And he has broad discretion over Manitowoc's operations to make sure critical supplies aren't held up.

"Buyers are the ones with the checkbook—and there's a huge power in that," says Mr. Ward. Recently, he was in France, agitated, and meeting with two Polish suppliers that weren't delivering all of the metal chassis they had promised to Manitowoc's big crane factory in Germany. No chassis means no cranes.

The president of one of the suppliers—who had just driven 16 hours from Poland to meet with Mr. Ward and other managers—announced unexpectedly that deliveries could actually slow further in coming months. "I have a lot of angry customers, because I have not been able to deliver cranes," said Mr. Ward, gazing at the Pole over the top of his half-glasses.

Mr. Ward is one of a new breed of purchasing gurus who have become a hot commodity in recent years. As more companies globalize and outsource production, they need a top-level point person who can manage these complex relationships, navigate various foreign cultures, and be willing to travel constantly.

(Annex 2007)

HORIZONTAL INTEGRATION AND THE ROLE OF PURCHASING

Management research argues that the functional alignment within an organization leads to an increased likelihood of achieving a competitive advantage (Hayes & Wheelwright, 1984). According to Cousins, Lawson & Squire (2006) companies perceive the integration of internal organizational functions and processes as challenging. A key issue here is that the strategic purchasing function nowadays is expected to not only integrate with other internal functions, but also to align with their supply chain activities (Cousins et al., 2006). However, the horizontal alignment of the different business functions in the value chain will lead to organizational success. Consequently, "the integration of one function with other functional units has been identified as a means to achieve strategic consensus, resulting in an ability to participate in further strategic activities and to contribute to the competitive position of the firm (Hayes & Wheelwright, 1984)" (Foerstl, Hartmann, Wynstra & Moser, 2013, p. 690). If an organization poorly integrates purchasing with the activities of other functions it often results in slow problem solving, poor information exchange and low levels of firm performance (Pagell, 2004 as cited in Cousins et al., 2006), while high levels of integration

can improve business performance (Cousins et al., 2006). Furthermore, researchers have documented how strategic purchasing actively stimulates cross-functional integration (Chen, Paulraj & Lado, 2004). The term “strategic” in this context refers to purchasing practices that may encourage the intra-organizational status of the function and are likely to contribute to the competitive position of the firm (Ramsay & Croom, 2008). According to Narasimhan and Kim (2002, p. 303) “[firms] need to proactively seek efficient linkage or integration among its various internal functions, and with its suppliers and customers comprising its supply chain”. Therefore, the purchasing function should strive for enhanced cross-functional integration in order to participate in strategic decision making, to align its practices consistent with internal requirements and to contribute to the competitive position of the firm (Kotabe & Murray, 2004; Foerstl et al., 2013).

But what is cross-functional integration within a purchasing context? And when the cross-functional integration of purchasing is important to organizational success, how can the contribution be explained?

Cross-functional integration within the context of purchasing could be defined as the interaction and collaboration of the purchasing function with other functions, such as product development, production, manufacturing and marketing (Narasimhan & Das, 2001; Pagell, 2004; Trent & Monczka, 2003 as cited in Foerstl et al., 2013). However, to explain the contribution of the purchasing department in the cross functional integration, the value chain will assist in the development of an explanation. The integration of the purchasing function with other function is a prerequisite to effectively address the supply market objectives that support the organizations in achieving its overall competitive targets (Carter & Narasimhan, 1996 as cited in Foerstl et al., 2013). As mentioned earlier, a poor integration of the purchasing function will have negative consequences for the organizational as a whole. The purchasing function may, for example, pursue a low cost strategy through multiple bidding rounds or volume concentration to leverage its bidding power. While according to the marketing and product development function, the success of the organization’s overall strategy may be strongly defined in terms of quality improvement and product innovation (Foerstl et al., 2013). In this situation, a misalignment between the functions is apparent and no overall goal is achieved. Such misalignment could lead to selecting the wrong suppliers and providing the wrong incentives to these suppliers, with damaging effects on purchasing performance in terms of quality and innovation (Foerstl et al., 2013) and indirectly on the whole organizational performance.

How then should purchasing integrate with other departments, on what issues and with which departments? Achieving integration of purchasing with other departments can be pursued in several ways: purchasing representation in top-level management, integrated cross-functional teaming, and measurement and reward systems based on contributions to competitive goals (Fitzpatrick, 1996; Robertson, 1995; Ellram and Carr, 1994; Gadde and Hakansson, 1994 as cited in Narasimhan & Das, 2001).

As the vertical alignment is discussed above, the horizontal, cross-functional teaming is described here. A cross-functional team is composed of those individuals from different functional departments whose competencies are essential in achieving an optimal evaluation, and including the purchasing department (Parker, 2003). To fully take advantage of such cross-functional teams a clear communication to the stakeholders and internal team communication is very important (Parker, 2003). Furthermore, such integration of purchasing with other functional departments concerns organizational change, develops strong internal

relationships through membership in strategy development teams, information sharing, and joint decision-making activities (Narashiman & Das, 2001).

More specifically, the purchasing department integrates with the manufacturing department. According to Narasimhan & Das (2001), integrating the purchasing department with the manufacturing department will have a measurable impact on the achievement of the manufacturing goals. Moreover, purchasing plays an important role in product development. Cross-functional teams are for example increasingly used in product development, where the teams are composed of individuals from marketing, R&D, manufacturing and purchasing (Sethi, 2000 as cited in Parker, 2003). In addition, the purchasing department can have an important contribution to the marketing department. The purchasing department can ensure funds are spent properly, improving the quality of advertising and communication and save time and money (Bals, Hartmann & Ritter, 2009).

The next section focuses on cross-functional integration as an internal driver and what it means for the purchasing department itself. How does this influence purchasing performance and organizational performance?

Internal drivers of the purchasing department

To receive an overall view of the purchasing function, its performance and the internal drivers, the research model of Foerstl et al. (2013) is used. More particularly, this model incorporates the two internally focused practices, cross-functional integration and functional coordination. In addition, it assesses and compares their individual impact on purchasing performance and, indirectly, on organizational performance (Foerstl et al., 2013). Findings of this study indicate the relative impact of cross-functional integration and functional coordination on purchasing performance. Cross-functional integration does not only seem to have impact on performance, but also on the competitive advantage. Moreover, according to Parker (2003) cross functional integration also gains competitive advantages for the firm such as, speed, complexity, customer focus, creativity, organizational learning. The focus of this part is the coordination of functions and departments within the organization. Functional coordination within the purchasing department could be defined as the common management of processes, products and services, and suppliers across the worldwide purchasing organization (Kotabe & Murray, 2004; Trent & Monczka, 2003 as cited in Foerstl et al., 2013). It seems to also take a more global perspective. Functional coordination enables synergy potentials from global purchasing operations to be realized in form of economies of scale, scope, process and learning (Faes et al., 2002 as cited in Foerstl et al., 2013). However, according to Ellegaard and Koch (2012) functional coordination is a difficult challenge when differentiation is high. In such a situation, functional integration acts as the glue that supports coordination and guarantees high performance.

Furthermore, there seems to be a total impact of talent management and a mediated impact of performance management on purchasing performance (Foerstl et al., 2013). Within the purchasing function, **talent management** is defined as a combination of selective staffing, comprehensive training, and appropriate job structures within the strategic purchasing function (Delaney & Huselid, 1996; Youndt et al., 1996, Giunipero et al., 2006 as cited in Foerstl et al., 2013). According to Foerstl et al. (2013) talent management plays an enabling role in achieving cross-functional integration and functional coordination through developing opportunities, adequate career paths, and the separation of roles within the function foster cross-functional integration and functional coordination.

Moreover, Reinecke, Spiller and Ungerman (2007) recognize that talent matters in purchasing. Reinecke et al. (2007), further identified three talent dimensions, including:

- The involvement of capabilities of the purchasing units themselves
- The way purchasers view their roles
- Involving purchasing executives more broadly in the business planning

Performance management within the purchasing function is defined as “the quantification of actions and the analysis of their effectiveness and efficiency (Neely et al., 1997)” (Foerstl et al., 2013). Performance management does not have a direct influence on purchasing performance; there is a mediated impact through cross-functional integration and functional coordination (Foerstl et al., 2013). Therefore, performance management directly influences cross-functional integration and functional coordination. Indeed, according to Narasimhan and Das (2001) measurement and reward systems based on contributions to competitive goals, positively impact the cross functional integration. Performance management is for example positioned to stimulate strategy implementation processes within the strategic purchasing function (Axelsson et al., 2002; Wagner and Kaufmann, 2004 as cited in Foerstl et al., 2013).

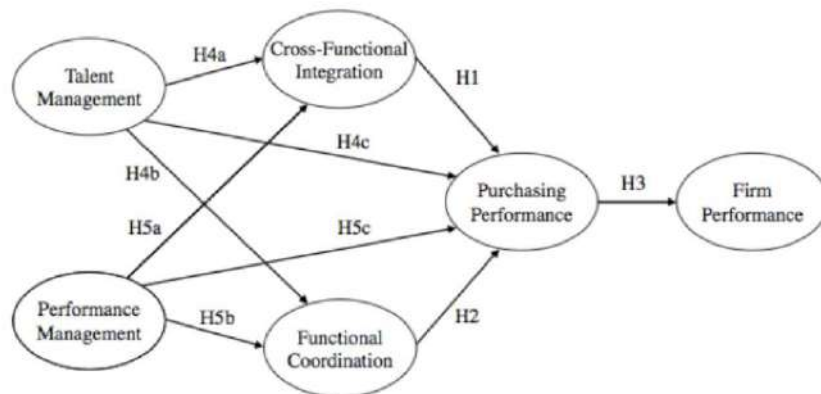


Figure 2.3: Cross-functional integration and functional coordination research model (Foerstl et al., 2013)

Organizational performance and the purchasing department

It seems that strategic purchasing plays a crucial role in organizational performance. Literature links strategic purchasing to different kinds of performance, financial as well as non-financial. According to Carr and Pearson (2002), strategic purchasing is positively related to a firm’s financial performance. It seems that a lot of studies have particularly acknowledged the operational and financial performance implications of strategic purchasing (Carr & Pearson, 1999; Chen et al., 2004 as cited in Foerstl et al., 2013). According to Knoppen and Sáenz (2015), purchasing plays a strategic role in an organization; its influence on performance will extend beyond traditional cost improvements to include strategic benefits related to the value proposition of the firm and the development of new products and markets, highlighting its non-financial contribution. “The value proposition and therefore performance may have different dimensions, such as price (cost), quality, delivery, variety,

innovation, and sustainability.” (Knoppen & Sáenz, 2015, p.126). Firm performance, the performance of the buying organization, can also be defined as the financial and commercial performance of the buying organization (Gonzales-Benito, 2007; Smith David et al., 2002 as cited in Foerstl et al., 2013). Foerstl et al. (2013) recognizes the positive link between purchasing performance and firm performance. However, for which reasons does the performance of the purchasing department impact the overall performance of the organization? In the study of Foerstl et al. (2013), three reasons are mentioned. First, purchasing performance positively affects the organization’s top-line in contributing to sales growth and market share growth by its contribution in terms of quality and innovation (Spekman et al., 1999; Paulraj et al., 2006 as cited in Foerstl et al., 2013). Second, purchasing performance positively affects the balance sheet of organizations through enhanced asset utilization and reduced capital lock-up (Ellram & Liu, 2002). Lastly, purchasing performance has a positive bottom-line impact on the profit and loss statement in terms of cost reductions (Ellram, Zsidisin, Siferd & Stanly, 2002). As purchasing contributes to the value creation of the organization’s products and services, purchasing also increases the value of the organization itself (Ellram et al., 2002). Also, such value creation of purchasing department is pointed out in the contribution it has on the of organization’s overall sustainability (Tate et al., 2010 as cited in Schneider & Wallenburg, 2012). This is mainly due to the purchasing department’s position at the starting point of the flow of materials into the organization (Carter et al., 1998; Porter and van der Linde, 1995 as cited in Schneider & Wallenburg, 2012).

PREVENTING A MISALIGNMENT

Within organizations the functional areas such as marketing, finance, operations and purchasing can result in conflicts over expectations, preferences and priorities (Olivia & Watson, 2011). Since a misalignment of the organizational functions can have a negative consequence for the functional departments and the overall firm performance (Kaplan & Norton, 2006), this should be prevented. Consequently, how can firms prevent a misalignment? Today, many organizations consist of business functions, each with highly trained, experienced and motivated managers. But often the individual efforts are not coordinated and there is no alignment between them. Such a misalignment is often due to a different and conflicting department strategies and objectives. These different departments have a different set of KPI’s and performance is differently measured. For example the purchasing department can measure the performance by cost KPI’s, such as the costs of a purchase. However, Marketing can focus more on the quality KPI’s, such as quality ratings (Kaplan & Norton, 2006).

To coordinate and manage these performance measures of different functions, good performance management is of critical importance. As already introduced by the research of Foerstl et al. (2013), Performance management can be seen as a means to develop and increase the alignment of decision-making in the purchasing function; across different business functions and locations within the purchasing function, as well as across organizational business functions. When individual buyers feel that the efforts they make are appraised, they will be motivated to exert effort towards specific tasks (Pagell et al., 1996). For this reason, the overall organizational strategy must not only be translated into understandable performance goals and actions for the specific departments, but also for the individual employee working in the purchasing function. In other words it can be said that performance management can be seen as a tool to guide employee efforts towards the strategic goals of the purchasing function (Wagner and Kaufmann, 2004 as cited in Foerstl et

al., 2013). The need for a horizontal alignment becomes clear when considering the different perception the organizational functions have of a purchase. This perception about the most important aspects of a purchase result is multi-dimensional and differs between internal customers, such as marketing or production, and the purchasing function (Ramsay & Croom, 2008). This highlights the critical participation of performance management in cross functional-integration. The paper of Caniato, Luzzini and Ronchi (2014) shows that organizations still only adopt measurements such as cost, time and quality. However, as purchasing has obtained an crucial role within the organizations new performance indicators have been created such as flexibility, innovation and sustainability and are becoming increasingly important (Caniato et al., 2014).

The balanced scorecard (BSC) is the most widely used performance management tool today (Johnson 2011 as cited in Ratnayake & Markeset, 2012). “It intensifies the focus on the strategy and identifies the management and organizational actions required to get performance back on track (Kaplan and Norton 2000a)” (Ratnayake & Markeset, 2012, p.153). The Balanced Scorecard determines five principles for strategy management: mobilize, translate, align, motivate, and govern (Kaplan & Norton, 2001).

Focusing on the alignment principal Kaplan and Norton (2008) explained the alignment principle as how to create and capture corporate synergies through vertical and horizontal alignment of business and support functions. It’s a tool to align the overall strategies with the functional strategies and the functional strategies with each other.

BARRIERS TO HORIZONTAL INTEGRATION & PURCHASING INVOLVEMENT

As an organization you want to realize integration between functions. Not always this will be achieved. In this part barriers to horizontal integration are discussed, furthermore possible conflicts that come forth from low integration will be evaluated. The first example is from Ellegaard & Koch (2014), where a construction company and conflicts deriving from lowly integrated organizational functions have been investigated. In the research, Ellegaard and Koch (2014) discuss a high differentiation and low integration setting. Differentiation is defined as “the difference in cognitive and emotional orientation among managers in different functional departments” (Ellegaard & Koch, 2014, p.328). In other words, the way managers experience certain events differs per department. The reason for this is that every department has its own set of goals and therefore develops different views on organizational goals.

“Differentiation and integration are closely connected because high differentiation requires high integration for effective organizational functioning” (Ellegaard & Koch, 2014, p.327). Therefore it is argued that when integration is low and differentiation is high, conflicts will happen. Conflicts negatively influence integration, as it can damage both parties performance in the organization.

Figure four represents how two departments reason when departmental integration is low while differentiation is high. Without proper integration the cycle is vicious and destructive conflict is inevitable. To prevent this from happening executives must monitor both departments and act accordingly.

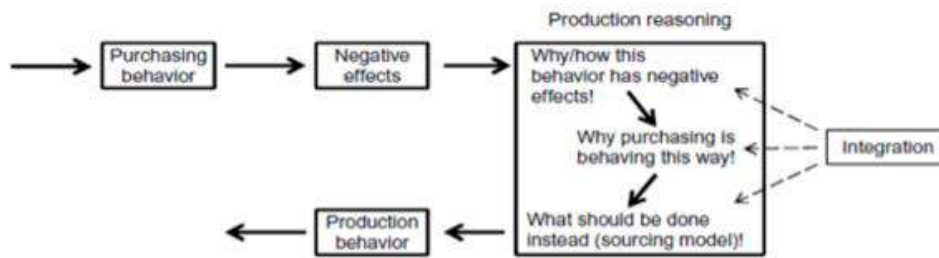


Figure 2.4: Purchasing integration problems (Ellegaard & Koch, 2014)

The second example comes from a research based on key supply management (KSM). In this research the lack of integration of the purchasing function internally is discussed. The result shows that the purchasing function has difficulties positioning itself internally. One quote of a global purchasing manager stated: “I do not have the status to go and speak with the Head of R&D. The R&D department works directly with suppliers with no participation of the purchasing department” (Pardo, Missirilian, Portier, & Salle, (2011), p.859). Another sourcing manager reasoned that it is tradition in purchasing to have certain autonomy within the company and therefore the purchasing department has limited influence within the firm (Pardo et al, 2011). Finally, another company in the research was positive about the integration of the departments, and stated that decisions are made for the long term with a global perspective. The level of integration was not easy to reach but after some years they managed to integrate the purchasing, R&D and the business network to work in the same direction (Pardo et al., 2011). The statement of the last company shows that integration takes time, however if worked upon, achievable for an organization. The figure five below shows barriers on KSM.

Barriers to KSM.

Barrier	Barriers details
Difficulty in implementing supplier portfolios	<ul style="list-style-type: none"> • Multiplicity of purchasing situations • Difficulty in establishing suppliers' hierarchy • Focus on “spend” and “criticality” criteria only • Difficulty in finding out other hierarchy criteria • Lack of strategic intent
Limited understanding of value co-creation levers with suppliers	<ul style="list-style-type: none"> • Focus on competition • Focus on savings • Lack of specific relational skills
Lack of integration of the purchasing function with other internal functions	<ul style="list-style-type: none"> • Absence of change management; lack of support • Difficulty of purchasing to position as a real boundary-spanning function • “Status” of purchasing • Insulation of purchasing within the organization • Weak integration of purchasing within the company strategy

Figure 2.5: Barriers to integration of purchasing function (Pardo et al., 2011, p.859)

The third example that covers barriers to integration is concerned with a marketing department. In this study Bals et al. (2009) investigate the involvement of the purchasing department within the marketing service procurement. One of the topics discussed in the article by Bals et al. (2009), deals with the barriers that prevent the purchasing department from involvement in the marketing department. By using an example, where marketing spending is relatively high and where the organization has a separate marketing and purchasing department, Bals et al. (2009) develop a conceptual research model about the mechanisms of purchasing departments' involvement in marketing service procurement. Through interviews between departments, as shown in the figure six below, the authors tried to gather reliable information regarding the topic.

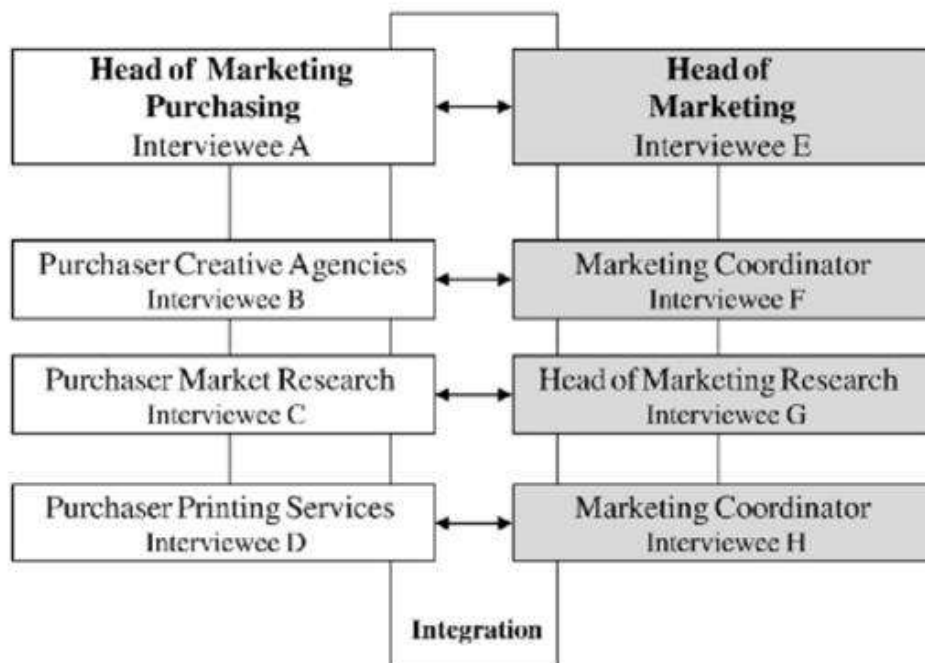
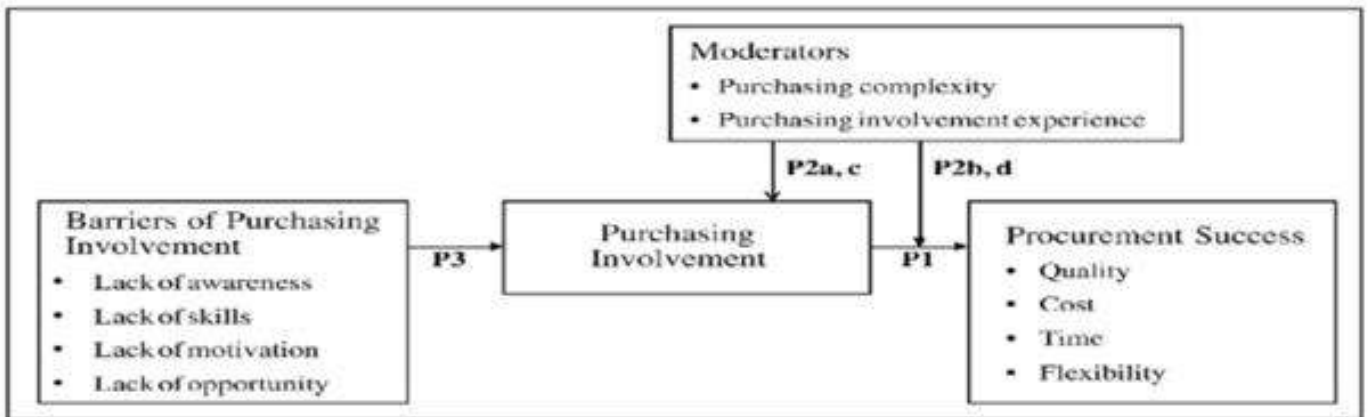


Figure 2.6: Integration of Purchasing and Marketing (Bals et al., 2009)

Results from research suggested that the involvement of the purchasing department adds value in terms of quality, timely delivery and costs. Furthermore, it showed that in this case the involvement of the printing services showed to be rather high but varied for the agency services. In this case the barriers to the purchasing department mostly determined the involvement. The question that rises is: What are the main barriers concerned with the purchasing involvement and how to overcome these barriers. One of the issues that are covered is in “Rogue procurement” also known as “Maverick Buying”, which will be discussed later in this chapter. Maverick Buying involves purchasing from a department without honoring the purchasing contracts established by the purchasing department. Furthermore, major decisions in the marketing and communication departments are often made without involving the purchasing department, often because of unawareness or a lack of appreciation for the integration with the purchasing department (Bals et al., 2009). In figure seven below, which describes the barriers that are considered to hinder the purchasing involvement to be successful (Bals et al., 2009).



Propositions

- P1 *With increasing purchasing department's involvement in marketing service procurement, procurement success increases.*
- P2a *With increasing levels of procurement complexity, the purchasing departments' involvement increases.*
- P2b *With increasing levels of procurement complexity, the impact of the purchasing departments' involvement on procurement success increases.*
- P2c *With increasing levels of involvement experience of both marketing and purchasing representatives, purchasing departments' involvement increases.*
- P2d *With increasing levels of involvement experience of both marketing and purchasing representatives, the impact of purchasing departments' involvement on procurement success increases.*
- P3a *The lower the lack of awareness of marketing representatives, the higher the degree of purchasing involvement in marketing service procurement.*
- P3b *The lower the lack of skills of purchasing representatives, the higher the degree of purchasing departments' involvement in marketing service procurement.*
- P3c *The lower the lack of motivation of both marketing and purchasing representatives, the higher the degree of purchasing departments' involvement in marketing service procurement.*
- P3d *The lower the lack of opportunity for both marketing and purchasing representatives, the higher the degree of purchasing departments' involvement in marketing service procurement.*

Figure 2.7: Barriers of purchasing involvement (Bals et al., 2009)

The figure above shows that a lack of awareness, skills, motivation or opportunity can all stand in the way of purchasing involvement. In this case the marketing department would preferably minimize contact with the purchasing department when there was nothing to be gained in terms of content expertise (Bals et al., 2009). It can be seen that purchasing complexity and purchasing involvement experience were moderators to the purchasing department's involvement. The research results indicated that where purchasing complexity increased for the marketing department, they sought expertise from other functions instead of expertise from the purchasing department. This was the case because the purchasing department did not have the category expertise; therefore, the involvement of the purchasing department declined further when complexity increased (Bals et al., 2009).

Maverick Buying

Maverick buying is a very dynamic topic in purchasing literature. “**Maverick buying** (MB) is the non-compliant, off-contract buying of goods and services, for which an established procurement process is in place based on pre-negotiated contract with selected partners” (Karjalainen & van Raaij, 2011, p.185) In other words, MB or “rogue procurement” as mentioned earlier, is the purchasing of goods or services without using the established purchasing contracts. The figure below shows a framework, which identifies five different

forms of MB. Reasoning for these forms of MB were extracted from a literature review and conducting twelve exploratory interviews.

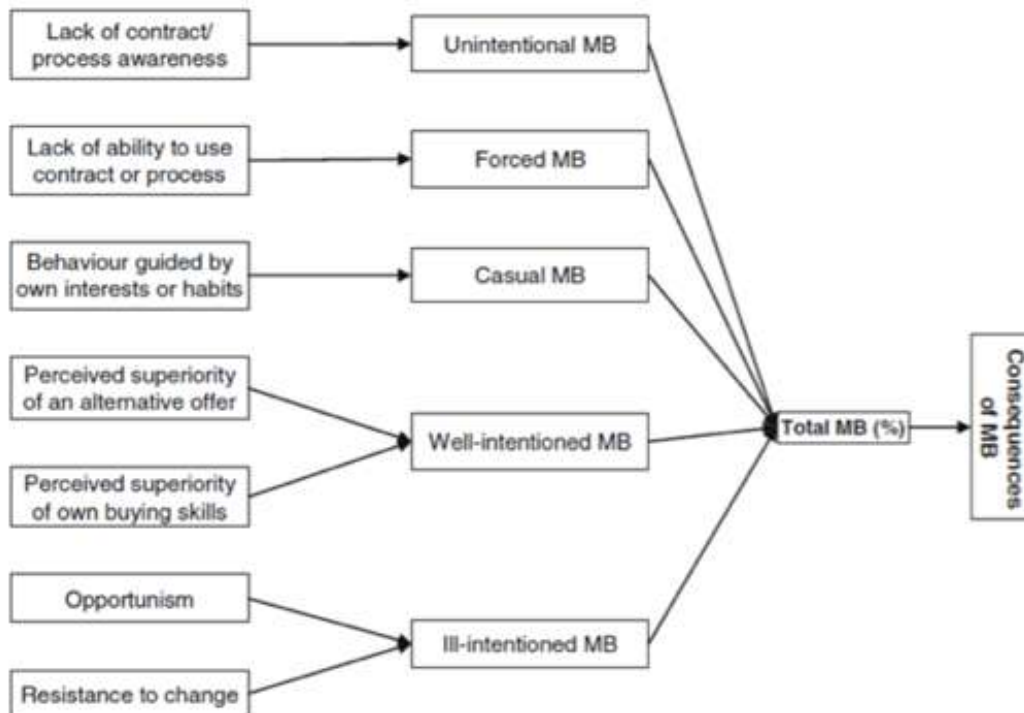


Figure 2.8: Maverick Buying (Karjalainen et al., 2009)

Important to know for an organization and especially for the purchasing department is how these different forms of MB and the general issue can be reduced. According to Karjalainen et al. (2009), the unintentional MB can be reduced by creating awareness, just as in the example of Bals et al 2009, the lack of awareness creates a barrier between departments and in this case causes MB. To increase awareness, strong leadership of the purchasing department is essential. Better educating about the contracts and training employees to use the purchasing systems could reduce forced MB (Karjalainen et al., 2009). The casual MB and well-intentioned MB are cases in which the organization lacks in leading and educating employees in purchasing practices. Lastly the Ill-intentioned MB can improve by frequently monitoring and involving employees in the contracting process (Karjalainen et al., 2009).

Following the research of Karjalainen et al. (2009), Karjalainen and van Raaij (2011) identify three forms of maverick buying. Firstly, “Maverick buying, to get better terms and conditions”. This form is referred to as employees who assume they are able to buy cheaper locally compared to the price, which has been agreed upon in the centralized purchasing contract. Thereby they do not take into account the total cost of ownership (TCO). Moreover, this encompasses purchasing costs but also risks in terms of cancellation, general terms and conditions or after sales services. Another example may be, when employees try to optimize their departmental utility and ignoring organizational utility (Karjalainen & van Raaij 2011). This example fits into the casual MB of the Karjalainen et al. (2009) model. Secondly, “Maverick buying to maintain a previous supplier relationship”. This type of maverick buying is concerned with maintaining a long lasting relationship and relates to human behavior. Human behavior means that humans are creatures of habit and prefer to purchase at a certain supplier they have purchased from before. Moreover, personal relationships between the department and the purchaser could influence the purchasers’ behavior (Karjalainen &

van Raaij, 2011). Thirdly, “Maverick buying due to unawareness of frame agreements in existence”. This is referred to as unintentional MB and accounts for the most cases of MB. It is often caused by a lack of information and miscommunication between departments. Especially in the sense of globalization, MB is an issue that needs to be controlled for.

After having discussed different types of MB, it is important to identify the implications of MB to the horizontal alignment between departments. An important question that rises is: “How can you ensure that maverick buying does not happen?” It is not possible to give a clear answer on this question. However, according to the literature, by reducing the autonomy of the purchasing task and making buying highly programmed, maverick buying for the last three discussed forms can be reduced (Karjalainen & van Raaij, 2011). Furthermore, correctly informing employees about purchasing procedures and clear communication should decrease MB. Moreover, internal organizational training on purchasing rules and regulations MB can be reduced significantly (Karjalainen & van Raaij, 2011).

CONCLUSION

This chapter is the basis of the following six chapters of the book. The internal aspects of the strategic purchasing department have been discussed and as already mentioned throughout the chapter, external issues, which are main topic of further chapters, rely on the internal aspects.

Internal alignment is the essential step to establish a sustainable supply chain as referred to earlier in the case study of Apple Inc. (Sisco & Wong, 2008). The purchasing department is one of the organizational functions that have been influenced by such vertical and horizontal alignment. In this chapter it has been highlighted that there exists an important vertical link between the corporate strategy and the purchasing strategy, by aligning the objectives of both strategies. To get an overview of different organizational strategies it has been built upon the Porters’ Generic Framework by including more recent concepts of product leadership and operational excellence. The importance of aligning strategies from the perspective of the purchasing department has been discussed and some guidance on how to do this, supported by literature has been given. Furthermore, the make-or-buy decision is explained as well as the consequences it will have for the purchasing department and the alignment of strategies. The discussion has been ended about the vertical alignment with the impact of centralization and decentralization on the purchasing department and the concept of hybrid purchasing.

In the second part, horizontal integration and the role of purchasing has been discussed. Furthermore Cross-functional teams and the need for cross-functional integration has been discussed. Investigations have shown that cross-functional teams can assist in aligning different departments. As a main reason for this, the understanding for the issues and problems of each department has been identified. Furthermore, internal drivers of the purchasing department have been identified. As a result certain drivers can be mentioned, these include the involvement of capabilities of the purchasing units, the way purchasers view their roles and the involvement of business executives. In terms of the purchasing department attributing to performance it contributes to the value creation of the organization’s products and services, and increases the value of the organization itself.

Conflicts can arise between the different functional areas, because of opposed strategies and objectives. Since a misalignment of the organizational functions can have a negative consequence for the functional departments and the overall firm performance (Kaplan &

Norton, 2006), this should be prevented. To prevent such a misalignment, performance measurements have to be aligned between these departments. This means that the overall organizational strategy must not only be translated into understandable performance goals and actions for the specific departments, but these different performance measures also align horizontally. As such, the different functional departments work towards a common goal. Furthermore, it can be said that performance management can be seen as a tool to guide employee efforts towards the strategic goals of the purchasing function (Wagner and Kaufmann, 2004 as cited in Foerstl et al., 2013). When all departments and employees have the same expectations, preferences and priorities, this will positively impact the organization's success (Olivia & Watson, 2011).

Barriers to horizontal integration showed that the purchasing department has difficulties positioning itself internally. Furthermore research indicated that the purchasing department experiences some kind of autonomy and therefore positions itself more to the outside in comparison to the other departments. In order to overcome these barriers the purchasing department and the other departments it works with must work together to improve integration and collaboration. The example of Bals et al. (2009) showed that barriers are influenced by a lack of awareness, skills, motivation or opportunity. Maverick buying showed that the purchasing department cannot always hold other departments to their purchasing contracts. It is very hard to prevent maverick buying, however, taking the right precautions can reduce it.

One limitation of this chapter is, that the examples used for explaining barriers to integration are just some examples from the extended literature on this topic. The examples chosen represent a basis for barriers that a purchasing department could be confronted with, however, do not cover all possible barriers to the purchasing department. Further limitations are the accessibility to data as well as the time frame and limited word count. Furthermore, future studies could investigate further risks to the purchasing department besides MB.

Moreover, this chapter has several implications to management practices. One implication is for example to ensure a coherent strategy, in the sense of an alignment of all strategies within an organization. This chapter has pointed out that the strategy alignment first needs to be vertical and then horizontal. However, drivers, barriers and risks have been addressed as well to give an overall picture of issues concerning internal aspects of a strategic purchasing department. This should allow the reader to gain new insights in recognized topics and identify different opportunities to deal with those.

FUTURE SECTION

The following paragraph should give an idea of future trends that are expected to occur relying on current developments. Results that have been gained throughout the development of this chapter, led to the following future expectations. As organizations in future continue to increase in size, and business is conducted globally more often, the role that the purchasing department plays is vital. The integration of the purchasing department will be essential to its success. Due to rising numbers of competitors, firms have to further defend and extend their market position by adjustments and improvements in corporate strategies as well as by continuous innovation. This has also an effect on the purchasing department as changing management objectives need to be in line with the overall strategy. Furthermore, globalization will play an even more important role in purchasing. In relation to this chapter, it can be expected that risks such as Maverick Buying will be more intensive. It is further expected that the internal alignment of strategies will be more challenging, as parts of the company will be in foreign countries or even outsourced to different organizations.

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Chapter 3

SOURCING STRATEGIES

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Abstract:

The external aspect of strategic purchasing discusses sourcing strategies. This includes global sourcing, which focuses on offshoring, nearshoring, inshoring and backshoring. Furthermore, category management is critically reviewed as a strategic approach. Additionally, the portfolio models are discussed in relation to different strategies including best value procurement and low-bid procurement. Then the supplier selection is addressed with supply base, sourcing and scouting, and single versus multiple sourcing. In the end, selection criteria are discussed.

Key words:

- **Category management**
- **Kraljic matrix**
- **Best value procurement**
- **Supply base**
- **Single versus multiple sourcing**

INTRODUCTION

Nowadays, suppliers do not solely have impact on reducing costs and improving quality of products or services, but suppliers are also more involved and integrated in processes such as the product design and development. The selection of the right suppliers and composing the optimal supply base has become one of the most challenging parts of strategic purchasing, due to the continuous changing and a highly competitive environment, higher expectations & requirements of customers the uncertainty and risk collaboration of buying companies grows. Also the collaboration with different suppliers around the world entails a global focus and view of many industries nowadays. However when done right and effectively, it is a strategic tool to gain or maintain a competitive advantage (Sarkis & Talluri, 2002). Therefore carefully considered strategic decisions about which and how many supplier(s) to select is very important in order to deal with these external trends in most sectors (Parmar, Wu, Callarman, Fowler & Wolfe, 2010) and eventually could lead to higher quality of products and services, lower costs, greater customers satisfaction and at the end higher profits (Paul, 2015).

First a small introduction to sourcing strategy is given, after that global sourcing and category management is mentioned. From category management the next topic shall be portfolio models, with the emphasis on the Kraljic matrix. This model will be critically reviewed by discussing different advantages and disadvantages. Both category management and portfolio models are linked to the products of the company. Different strategies that can be used regarding Kraljic and other scholars will be discussed, for example Best Value Procurement. The products of the buying company should be grouped, before the selection of suppliers can occur. Therefore, this subject will be covered after the portfolio models paragraph. In the selection of suppliers, the supply base is discussed, this supply base includes topics as single-sourcing vs. multiple sourcing. At the end different criteria for selection of suppliers are mentioned.

INTRODUCTION TO SOURCING STRATEGY

The first part of the chapter will focus on the position of the sourcing strategy relative to the business and organizational strategy. Thereby, the alignment of purchasing department activities with the overall strategy (chapter 2) is iterated and envisioned. This is the base of sourcing strategy, as alignment will always have to be back in mind in order to be successful.

Place sourcing strategy in the corporation

Strategic sourcing, is defined by Anderson and Katz (1998) as “a wide range of activities namely creating an overall strategy for sourcing, evaluating and selecting suppliers, procuring materials/services and managing supplier relationships”. Similarly, Van Weele (2010) defines **sourcing** as the part of the purchasing process that aims at selecting and managing suppliers aligned with strategic organizational goals and objectives. Thus, sourcing strategy includes procurement of materials and/or services as well as selection and management of suppliers aligned with organizational strategy. Sourcing has increased in popularity, generally taking a prominent place in the purchasing process of companies (Zeng, 2000).

Figure 3.1 envisions the latter definitions. The sourcing process, which is circled red, includes the strategy in place for specification, selection and contracting, which is aligned with the corporate strategy as well as the business strategy. It is important to consider the fact that corporate strategy, business strategy and purchasing strategy are interrelated and can influence on another (as mentioned in chapter 2). Thus, the purchasing strategy could possibly also trigger

changes in the business strategy or even corporate strategy meaning that alignment is not solely determined in a top-down manner.

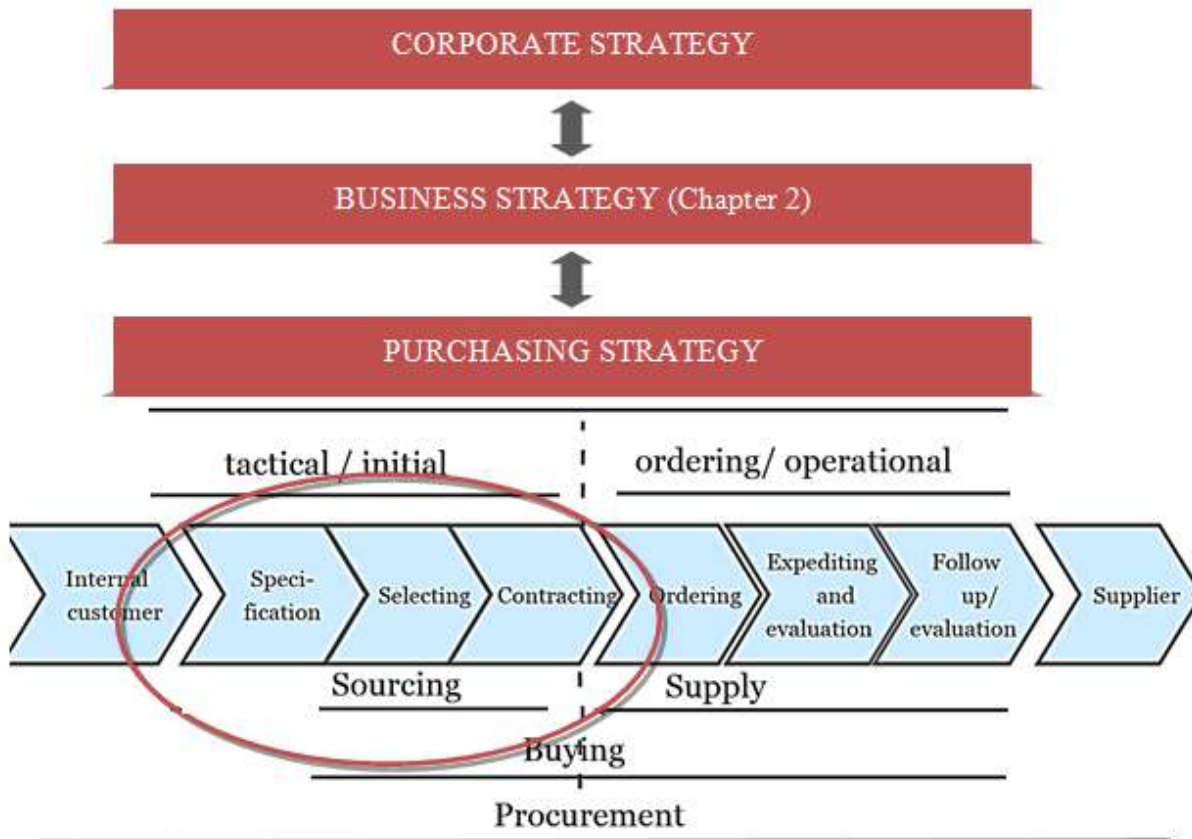


Figure 3.1 Sourcing strategy defined. Adapted from van Weele (2010) and Johnson & Howard (2014)

GLOBAL SOURCING

After discussing the make or buy decision in chapter two by discussing insourcing as well as out-sourcing, the out-sourcing will be elaborated on by extending it with a view on global sourcing. Global sourcing can be identified as seeking for foreign supply sources to including in the overall purchasing strategy (Holweg et al., 2011). In other words, it involves the geographical decision regarding outsourcing made during the sourcing process.

There are many definitions of outsourcing, the one used in chapter two stating that **outsourcing** is the “use of outside agency to manage a function formally carried out inside the company” (Bénaud and Bordeianu, S., 1998, p. 2) is just one of many. Common ground in all these definitions is the external agent executing the outsourcing activity (Willcocks et al., 1995). When one considers a more global perspective on outsourcing, the term offshoring or offshore outsourcing comes forth. This is similar to outsourcing except that the specialized capabilities are accessed from external agents across geographical borders (Jacob et al., 2009; Sobol & Apte, 1995; Weerakkody & Irani, 2010). This is, therefore, also referred to as global outsourcing (Sobol & Apte, 1995; Walsham, 2002). Different incentives are of interest when outsourcing globally compared to the outsourcing in proximity. The main incentive for most multinationals is cost reduction (Ayra et al., 2013; Lewin & Peeters, 2006) especially due to low labor cost (Hollensen, 2008; Weerakkody & Irani, 2010). Even though this can lead to

lower cost, companies are more exposed to facing quality problems due to differences in standards and lack of control (Hultman et al., 2012). Additionally, cost reduction due to economies of scale, experience and higher quantities of production of suppliers can reduce the cost per unit of production (Hollensen, 2008). Besides the cost perspective, it can be aimed to tap into capabilities that are unavailable or supplement the existing capabilities of the firm. This could be in terms of knowledge, innovation capabilities, access to technologies and other resources (Hollensen, 2008), access to skilled labor pools and competitive pressure (Lewin & Peeters, 2006). Thus, offshoring is often used as source of corporate transformation and business renewal (Li et al., 2008).

Besides the possible benefits to offshore, one should take into consideration that sourcing multiple activities from multiple suppliers from different global locations increases the complexity and cost of management (Dibbern et al., 2008; Larsen et al., 2013; Stringfellow et al., 2008). Moreover, the increase of complexity makes it harder for managers to consider all factors relevant for decision-making prior to offshoring increasing the chance of cost estimation error and unexpected cost (Larsen et al., 2013).

Therefore, the factors for selection of suppliers are provided to taken into consideration for decision-making, namely strategic and organizational factors. The metrics for strategic performance are based on competitive priorities, which are cost, quality, time, flexibility and innovativeness (Weelwright & Hayes, 1985 in Dou & Sarkis, 2010). The organizational factors are more focused on firm characteristics and capabilities, more specifically on culture, technology and relationships (Dou & Sarkis, 2010). This can be found in figure 3.2.

Strategic performance measures	Organisational factors
<p>*Cost (CT)</p> <ul style="list-style-type: none"> Low initial price Compliance with cost analysis system Cost reduction activities Compliance with sectoral price behaviour <p>*Quality (QY)</p> <ul style="list-style-type: none"> Conformance quality Consistent delivery Quality philosophy Prompt response <p>*Time (TE)</p> <ul style="list-style-type: none"> Delivery speed Product development time Partnership formation time <p>*Flexibility (FY)</p> <ul style="list-style-type: none"> Product volume changes Short set-up time Conflict resolution Service capability <p>Innovativeness (IS)</p> <ul style="list-style-type: none"> New launch of products New use of technologies 	<p>*Culture (CE)</p> <ul style="list-style-type: none"> Feeling of trust Management attitude/outlook for the future Strategic fit Top management compatibility Compatibility among levels and functions Suppliers organisational structure and personnel <p>*Technology (TY)</p> <ul style="list-style-type: none"> Technological compatibility Assessment of future manufacturing capabilities Suppliers speed in development Suppliers design capability Technical capability Current manufacturing facilities/capabilities <p>*Relationship (RP)</p> <ul style="list-style-type: none"> Long-term relationship Relationship closeness Communication openness Reputation for integrity

Figure 3.2 Performance measures vs. Organizational factors (Adapted from Sarkis and Talluri, 2002 & Chan, 2003 in Dou & Sarkis, 2010)

Outsourcing activities that are less globally oriented are nearshoring and inshoring. Inshoring is when the job is relocated domestically (Liao, 2012), thus does not cross the border. Similarly, nearshoring is characterized by relocation of tasks to locations in close geographical proximity of the firm, thus crossing the border, but staying relatively close. Lastly, a new trend is backshoring, which is bringing back offshoring to the domestic country. This could

happen after evaluation of the supplier, but also for sustainability reasons (later discussed in chapter 7).

CATEGORY MANAGEMENT

In traditional brand management, “individual brand-oriented buyers search to improve their economic performance by procuring large quantities of product on deals and then relying on retail pricing, promotions, and merchandising activities to deplete brand-level inventories as quickly as possible” (Basuroy, Mantrala and Walters, 2001, p. 16). However, increasing complexity of procurement activities concerning increasing range and number of products, competition forcing to work effectively, customer segmentation, diversity of competitors due to globalization as well as increasing ranges of products, and abundance in availability of technology and information (Harris & McPartland, 1993) leads to the need for a different approach. **Category management** is an alternative to the traditional approach and is defined as a “process for managing entire product categories as strategic business units ... with an focus on delivering consumer value” (Desrochers, Gundlach and Foer, 2003, p201). In other words, category management moves away from determining performance of individual brands and towards performance of categories of products by recognizing interrelation of products (Basuroy et al., 2001). It is aimed to provide a win-win-win situation where suppliers, purchasers and consumers benefit from category management (Desrochers et al., 2003)

In theory, the outcomes of all parties can be enhanced (Pellet, 1994) as category management provides opportunities to operate a category as a business where purchasing and selection of the optimal product mix is executed per category in order to meet customer needs (Desrochers et al., 2003). It is believed to aid achieving cost reductions and effective consumer-oriented practices (Dupre & Gruen, 2004; Kurnia & Johnston, 2003). Additionally, increase in profit is assumed (Basuroy et al., 2001). Furthermore, category management is aligned with customer decision-making and the manner customers define their needs helping firm to take a selling perspective and get closer to the customer’s point of view (Dussart, 1998; Harris & McPartland, 1993). Moreover, it is stated that sales-building opportunities as well as strategic issues can be addressed more effectively at the category level (Harris & McPartland, 1993).

However, results are still somewhat contradictory and some claim that these benefits are exaggerated (Dussart, 1998). More specifically, the definition claims that deliverance of consumer value is key of the approach, whilst category management can lead to higher retail prices (Basuroy et al., 2001) and limited product choice as most profitable items are solely provided (Dussart, 1998). Furthermore, category management might not directly change customer satisfaction, therefore not directly increase profit (Dussart, 1998).

Category management can be achieved without collaboration of suppliers, but results will be enhanced when collaboration takes place due to the use of complementary knowledge (Dewsnap & Hart, 2004; Kurnia & Johnston, 2001, 2003). Furthermore, purchasers can have a large range and quantity of products across many categories, making it impossible to intensively manage all the categories (Gooner, Morgan, and Perreault, 2011; Lindblom, Olkkonen, and Ollila, 2009). Hence, the firm can select a lead supplier or category captain to tap into capabilities and resources (Aastrup, Grant, and Bjerre, 2007). A **lead supplier** is defined as “the supplier to the category that has the most influence (relative to other suppliers) over the retailer’s CM decisions and actions” (Gooner et al., 2011, p. 18). One step further is the **category captain** “in which a supplier, often the category leader, takes on a significant role in the retail management of the category, including the brands of competing suppliers” (Lindblom

et al., 2009, p1006). This approach is, however, controversial and comes with risks (Gooner et al., 2011). The lead supplier or category captain can behave opportunistically by favoring own brands (Gooner et al., 2011) thereby excluding or increasing cost of competing suppliers (Lindblom et al., 2009). In other words, it also influences competing supplier relationships and decreases competition possibly leading to increase in prices, decreased variety of products and decreased focus on innovation leading to an decrease in consumer value (Desrocher et al., 2003; Lindblom et al., 2009; Steiner, 2001).

In order to gain from lead suppliers or category captains, purchasers should monitor its suppliers continuously with clear guidelines for detection and punishment and motivate all suppliers to report opportunistic behavior (Gooner et al., 2011). Furthermore, it is expected that the performance benefits of being lead supplier or category captain outweigh the short term benefits of opportunistic behavior.

PORTFOLIO MODELS

Definition Portfolio model: “A tool that combines two or more dimensions into a set of heterogeneous categories for which different (strategic) recommendations are provided.” (Gelderman & van Weele (2003) IN Gelderman & Semeijn, 2006 p. 210)

As is already been said above, purchasing has evolved from a clerical buying function to a strategic business function. Therefore managing the products and supplier relations is important (Gelderman & Van Weele, 2005). Using portfolio models can do this. In this part of the chapter, the goal is to get more insight in the strategic part of defining a portfolio model and where in the model to put your products. The place of the products in the portfolio model divides your product portfolio into different kind of product groups. Since the place in the model affects how we deal with products, the division of the products must be executed carefully (Caniëls & Gelderman, 2005). This division in the product portfolio links to the strategic goals of the company, and is thus linked to chapter 2. Over the years, many kinds of matrices are developed. Since, 50% of the responding small companies and 85% of the big companies use Kraljic, the first part of this chapter will discuss the Kraljic matrix. (Boodie (1997) IN Gelderman & van Weele, 2002). In figure 3.3 an overview of different purchasing portfolio models that are developed over the years can be seen (Gelderman & Van Weele, 2005).

After discussing Kraljic its matrix, the strategic implementations of his model will be mentioned. After these implementations, the effects of globalization and negative aspects of Kraljic are discussed. The chapter ends with some additional strategies that can be used in portfolio models.

OVERVIEW AND COMPARISON OF PURCHASING PORTFOLIO MODELS					
	Elliott-Shircore and Steele (1985)	Hadelers and Evans (1994)	Lilliecreutz and Ydreskog (1999)	Olsen and Ellram (1997)	Van Weele (2002)
Name of the Model	Procurement positioning overview	Supply strategy square	Classification model	Portfolio model	Purchasing portfolio
Matrix Dimensions	Profit/value potential	Product's value potential	Economic profile	Strategic importance	Profit impact
Categories	Supply vulnerability Strategic critical Tactical profit Strategic security Tactical acquisition	(Not specified)	Complexity and risk profile Strategic Leverage Bottleneck Noncritical	Difficulty of managing Strategic Leverage Bottleneck Noncritical	Supply risk Strategic Leverage Bottleneck Noncritical
Recommendations for					
Strategic Items	Manage suppliers	Strategic partnerships	(Not specified, depending on the desired cooperation with the supplier)	Close relationship	Partnership
Leverage Items	Drive profit	Global trading		Leverage volume	Exploitation of power
Bottleneck Items	Ensure supply	Close relationship		Standardize and find substitutes	Assurance of supply
Noncritical Items	Minimize attention	Simple contracts		Standardize and consolidate	Systems contracting

Figure 3.3 Overview of different purchasing portfolio models (Gelderman & Van Weele, 2005)

KRALJIC MATRIX

The matrix that almost every purchaser knows is the Kraljic matrix. Kraljic first introduces this model in the article 'Purchasing must become Supply management' from 1983 (Kraljic, 1983). This matrix consists of two axes, to divide products of the company in a portfolio model. The first axis is the supply risk, the second axis the profit impact. In figure 3.4 the matrix can be seen (Gelderman & Van Weele, 2005). The two axes result in four quadrants that represent different forms of products: noncritical items, leverage items, bottleneck items and strategic items (Gelderman & Semeijn, 2006; Gelderman & Van Weele, 2003; Kraljic, 1983).

Profit impact	High	Leverage Items <ul style="list-style-type: none"> • Standard, substitutable • Alternate suppliers • High volume or cost 	Strategic Items <ul style="list-style-type: none"> • Strategically important • Substitution difficult • No alternate suppliers
	Low	Noncritical Items <ul style="list-style-type: none"> • Standard, substitutable • Alternate suppliers • Low volume or cost 	Bottleneck Items <ul style="list-style-type: none"> • Substitution difficult • Monopolistic market • Critical items
		Low	High

Supply risk

Figure 3.4 Kraljic matrix (Kraljic, 1983)

Supply risk is affected by three factors (Bode, 2004):

- Market risk: this is a measure for the availability of potential suppliers for the products, type of market (monopoly, oligopoly) and entry barrier of new suppliers to the market.
- Performance risk: a measure for the quality and performance delivered by suppliers. This can include things as access to new technologies.
- Complexity risk: the complexity of the products affects the supply risk. Standardization and product specifications affect this factor.

Profit impact can be defined with the use of three factors (Bode, 2004):

- Impact on profitability: this factor is the profit that is typically yielded on the purchase of each product.
- Importance of purchase: this addresses the importance of the product to the company.
- Value of purchase: this is a measure for the tangible and intangible costs the products brings with them.

These two factors result in a two-by-two matrix with four product groups: non-critical items, bottleneck items, leverage items and strategic items (Kraljic, 1983). The four product groups differ in the power position between buying company and supplier (Caniëls & Gelderman, 2005). Since the Kraljic matrix focuses on the view from the buying company, it can be used to minimize the supply vulnerability and make use of potential buying power (Caniëls & Gelderman, 2007). The four types of products each have their own characteristics and therefore need a different purchasing approach (Gelderman & Van Weele, 2005). The non-critical items are ordered frequently and thus cause high transactional costs. Therefore, the strategy must be focused on reducing costs (Gelderman & Van Weele, 2005). Bottleneck items causing supply problems and should therefore be handled with care, such that the supply risk is minimized (Gelderman & Van Weele, 2005). The leverage items have a low supply risk and a high profit impact (Kraljic, 1983). Therefore, the procurement of these products should be managed in such a way that the purchasing company will exploit its buying power (Caniëls & Gelderman, 2005). For the strategic items the supply risk and profit impact are high (Caniëls & Gelderman, 2005). This requires a more collaborative way of purchasing. These strategies are discussed in the next part. The case 3.1 is a hypothetical example of what is discussed in this paragraph.

Case Study 3.1 : “Pro-boat” Boat manufacturer

Boat manufacturer “Pro-boat” is a manufacturer of boats that are 8 to 12 meters in length. Several parts are bought from other companies. The manufacturer buys bolts and screws, engines, steel and showers to make their boats. Since a new head of procurement is assigned, the bought products are going to be managed by a portfolio model. At Pro-boat procurement firstly was done by the director himself. However, due to an excessive increase in the demand of boats from Pro-boat the director has assigned a new head of procurement, which is going to lead a small procurement department of 5 people. The head of procurement comes from another company where they used the Kraljic matrix to divide their products.

Therefore the bought products are going to be evaluated on two criteria: the supply risk and the profit impact. The bolts and screws are easy to obtain and therefore these products have a low supply risk. Also the profit impact of the bolts and screws is low, therefore the bolts and screws are so called non-critical items.

The engines are bought from one supplier. This is the company “Engines B.V.” These engines are bought for a relative high amount of money, thus the profit impact is high. Since there is only one supplier, the supply risk is also high. The engines are therefore strategic items.

The steel can be bought from several suppliers. This indicates that the supply risk is low. However, without the steel Pro-boat cannot manufacture their boats. Thus the profit impact is high. Steel is therefore according to Kraljic and the new head of procurement a leverage item.

The showers can be bought from only one supplier that manufactures showers especially for boats. The supply risk is therefore high. The showers are relatively cheap, in comparison to the engines and the steel. Therefore, the profit impact is low. The showers are thus so called bottleneck-items.

Strategic implementation Kraljic matrix

Kraljic’s matrix comes with three strategies with respect to risk and power in the buyer-supplier relation: “exploit”, “diversify” and “balance” (Kraljic, 1983). The strategies and their corresponding quadrant can be seen in figure 3.5 (Kraljic, 1983). In figure 3.5 the company strength is equal to the profit impact and the supply market strength is equal to the supply risk. These three strategies will be discussed in detail in this part.

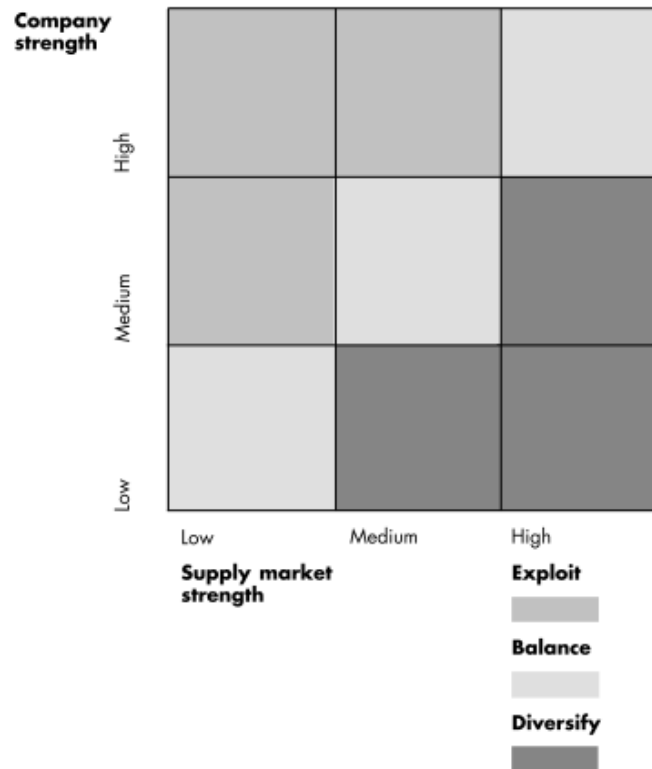


Figure 3.5 Strategies in the Kraljic matrix (Harvard Business review, 1983)

The exploit strategy can be used for the leverage items of the Kraljic matrix. For these items enough suppliers are available, since the supply risk of these products is low (Caniëls & Gelderman, 2005). The profit impact to the buying company is high, this means that a big amount of money is spend on these kinds of items (Gelderman & Semeijn, 2006). The exploit strategy is a strategy that is based on the fact that the buying company is in the dominant position (Caniëls & Gelderman, 2007). This means that the buying company has more power than the supplier. Due to this dominant position the buying company can use a more aggressive way of negotiating with the suppliers (Caniëls & Gelderman, 2005). The buyer can define the price it wants to pay for the leverage items and select suppliers based on the price they want for their products. Thus, this strategy aims for searching and selecting suppliers on the lowest price (Gelderman & Semeijn, 2006). However, this means that there is a constant pressure on price reduction by exploiting the bargaining power of the buying company (Caniëls & Gelderman, 2007). This includes aggressive negotiation and sometimes e-auctions are used. E-auctions use the competitive market to decrease the price of the products in an online auction (Bax, UMCG). However, a small note must be made about the price reduction strategy that is used for the leverage items. Hans Bax from UMCG states the downside of focusing on the price as: “A focus on the lowest price, will reduce the quality of the products you get” (Bax, UMCG). Since these products have a high profit impact on the buying company, the quality of their products should be of the standard they want. Thus, although focusing on the price the company should not lose the quality out of sight.

Alternatively literature suggest to leverage items and make them in-house (Johnsen & Howard, 2014), but then it should be cost competitive. Using this approach, the quality of the products can be maintained more easily, since the company produces the products itself.

Diversify strategy

The diversify strategy can be used for the bottleneck items. These items are known for their high supply risk and low profit impact (Caniëls & Gelderman, 2005). The difference with the products in the leverage items is that the supplier is in a dominant position, since there are not many suppliers available for the bottleneck items and therefore there are no negotiations possible on the price (Caniëls & Gelderman, 2007). Although the profit impact on the buying company is low, the company still relies on these products to maintain their business. The focus of the diversify strategy is therefore to ensure the supply of the bottleneck items and reduce the dependency of suppliers and risk regarding this bottleneck items. Increasing the stock of these products or having more suppliers to overcome the risks of losing the availability of the bottleneck items can achieve ensuring your availability of bottleneck items (Gelderman & Van Weele, 2005). However, since increasing the amount of bottleneck items in stock will increase the costs of your inventory, there is always a trade-off if this form of diversify-strategy is chosen. This trade-off is between having many bottleneck items in stock and having not enough bottleneck items available. The other option is having more suppliers. This will enhance the supply base complexity, since more suppliers are used. Thus, using the diversify strategy is always about weighting the possibilities and risks of losing the availability of the bottleneck items.

Globalization positively affects bottleneck items. By the globalization the supply risk will decrease due to a decreasing market risk (Johnsen & Howard, 2014). However, if the product still remains in the bottleneck product group, the company is always searching for new suppliers. This can be changed by having more information about the market and the demand of these kinds of products. By knowing the market optimally, the inventory of the bottleneck items can be optimized and therefore reducing the supply risk. However, this will mean that there are higher inventory costs. Also options should be explored for re-insourcing to produce these products. This will give security to the availability of the bottleneck-items, also the dependency of the supplier will vanish (Johnsen & Howard, 2014).

Balance strategy

The balance strategy can be used, according to Kraljic, for the noncritical and strategic items (Kraljic, 1983). The balance strategy is adapted for both of these kinds of items, however they share the characteristic that there is no dominant party, thus neither the buyer nor supplier can use their power (Caniëls & Gelderman, 2007).

First, the noncritical items are discussed. These items have a low profit impact and a low supply risk. The buying company is not in a dominant position since the profit impact is not high, suggesting that these products are not bought in big numbers or for high prices. The supplier is not in a dominant position since there are enough other suppliers who are competing (Caniëls & Gelderman, 2007). Therefore, the balance strategy for noncritical items advises to have contracts with many suppliers, based on the price of the product and the amount of effort needed to sustain the relationship (Caniëls & Gelderman, 2005). By doing this, the company will overcome the problem of losing a few suppliers with losing the risk of not having noncritical items available.

For the strategic items, the buying company is not in a dominant position since the supply risk is high due to the low amount of suppliers available for these strategic items (Kraljic, 1983). The supplier is not in a dominant position, since the buying company will spend a lot of money on these products (Caniëls & Gelderman, 2007). The buying company will (probably) spend a lot of money because these items are of strategic value to the company. Therefore, the supplier cannot risk losing this client. The balance strategy for strategic items therefore aims for long-term cooperation between the company and their supplier(s) (Kraljic, 1983). This cooperation can be fulfilled in different ways (Gelderman & van Weele, 2002):

- Joint research & development projects; in this case the supplier can be seen as an extension of the company.
- Having contracts with a small amount of suppliers. These contracts should take multiple criteria into account, which will be covered later on in the supplier selection paragraph.

Thus, the balance strategy for strategic items aims for a long-term relationship between the company and the suppliers (Kraljic, 1983). Due to this long-term focus, the company cannot sustain contracts with a lot of suppliers for these strategic items, since this will take too much effort (Caniëls & Gelderman, 2005). The case 3.2 is a hypothetical example that is used to increase the insight in the different strategies that can be used for the different quadrants. This case is a follow-up of the case 3.1.

Case Study 3.2: “Pro-boat” Boat manufacturer

After dividing the products in the product portfolio model. The strategic decisions on how to buy the screws and bolts, engines, steel and showers have to be made. The procurement department will use the strategies that can be used for the product portfolio model according to Kraljic.

For the screws and bolts, which are the non-critical items, the balance strategy is used. The new head of procurement advises his department to close contracts with 6 suppliers of screws and bolts. He gives this advice, because by closing contract with 6 different suppliers, the risk of having no screws and bolts is low. Also, Pro-boat can lower the price, by using the market effect.

Since the engines are the strategic items, procurement again the balance strategy. However, for strategic items the balance strategy is a bit adapted, according to the new head of procurement. He advises to cooperate with Engines B.V. and argued this with the argument that by cooperating with Engines B.V. the risk of losing the availability of the engines is lowered, and having joint venture development projects can enhance the quality.

The steel is a leverage item. The head of procurement advises to use the exploit strategy and trust on Pro-boat its buying power over the supplier. This will result in having contracts with several suppliers. Due to this several suppliers, the suppliers have to lower their prices to sell steel to Pro-boat. Thus, the price of steel will be lower than in the previous situation in which the director buys all the products in a more operational way.

For the showers, which are marked as bottleneck items, procurement will use the diversify strategy to ensure the supply of showers. The head of procurement also has experience with global sourcing and advises to search for global producers of showers especially for boats. After some searching for new suppliers on a global scale, the showers are bought at several suppliers worldwide. By sourcing globally, the showers turned from a bottleneck item into a non-critical item. This result makes the director of Pro-boat happy. In the time he was still purchasing products, the showers have delivered him some serious headaches.

EFFECTS OF GLOBALIZATION

The globalization of the last years has had an effect on the strategies that can be used in the portfolio model. Due to the globalization, Ulli Arnold has made a model for procurement strategies (Arnold, 1989). This model distinct four types according to the regional expansion of the market and the scope of the procurement activities, either operational or strategic (Virolainen, 1998):

- Traditional procurement; operative procurement in a national market. Well-defined demands for materials are properly met by using the national market.
- International purchasing; operative procurement in the international market. The goal of international purchasing is to supply the company's material demands at lowest possible costs (Arnold, 1989). Some of the international companies that use this form of procurement have established "buying offices." These offices only consists of a procurement department in a country where the international company wants to buy products (Arnold, 1989).
- Strategically oriented procurement; strategic procurement in a national market. This strategy does not only secure the supply of materials, but also enhances the research & development of companies by using international R&D knowledge (Arnold, 1989).
- Global sourcing; a partial corporate strategy that aims for the worldwide utilization of products sourcing. This strategy requires decisions about:
 - Potential targets in the source markets.
 - Organizational processes, about coordination and control of the company (Arnold, 1989).

These four types of procurement strategies can also be seen in figure 3.6 (Arnold, 1989). On one axis the amount of internationalization is used, on the other axis is the type of procurement strategy, either operative or strategic. Due to the globalization, the internationalization grows, this means that in figure 3.6 the companies go from the left to the right.

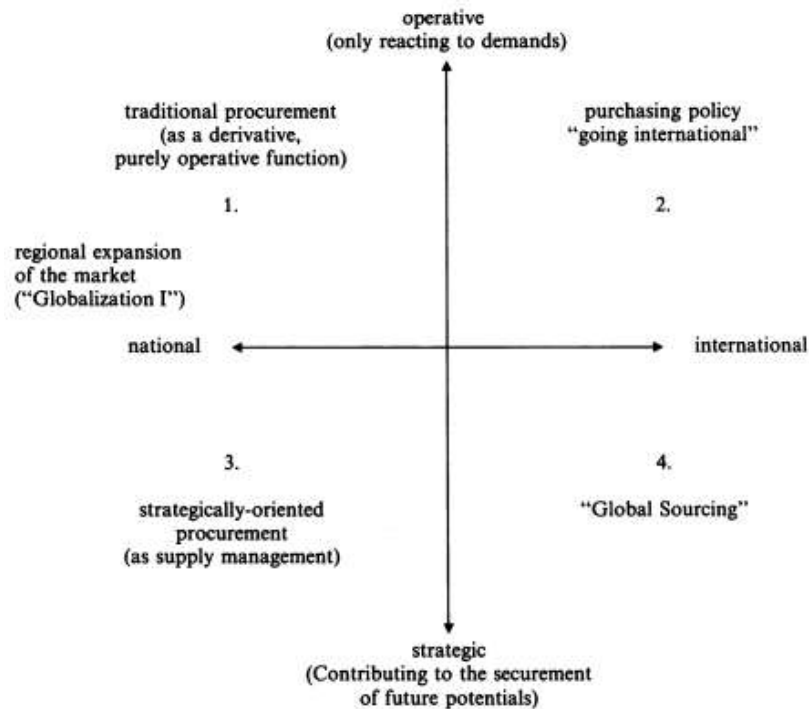


Figure 3.6 Global procurement strategies (Arnold, 1989)

Negative aspects Kraljic matrix

There are several portfolio models established after Kraljic modeled his matrix in 1983. However, Kraljic its matrix is still the dominant one that is used in the industry (Gelderman & Van Weele, 2005). Some of the other models can be seen in figure 3.3. However, these models show more similarities than differences in comparison to the Kraljic matrix (Gelderman & Van Weele, 2005).

While the Kraljic matrix is a well-known and often used tool, an often-heard regard is that it only takes into account the buyer its point of view (Gelderman & Van Weele, 2003, 2005; Spina, Caniato, Luzzini, & Ronchi, 2013; Virolainen, 1998). Another heard regard of the Kraljic matrix is that the strategies only focus on approaches that can handle the different characteristics of the four quadrants (Gelderman & van Weele, 2002). Therefore, in the next paragraph the negative aspects of the Kraljic matrix are discussed.

A mismatch between buyer and supplier may occur if the point of view of the supplier has not been taken into account (Virolainen, 1998). Partnering is only possible if both parties aim for partnering. Therefore, there is also a model that takes the suppliers' point of view as a starting position. This model is developed by van Weele and can be seen in figure 3.7. This figure is adapted from the lecture slides of Kirstin Scholten (RUG). In this model the products can be divided, based on two axes. The axes of this model are account attractiveness and relative value of the business (Gelderman & Van Weele, 2005). The account attractiveness is a measure for how important the buying company is to the supplier. The relative value of the business is a measure for the value of the products to the buying company (Gelderman & Van Weele, 2005).

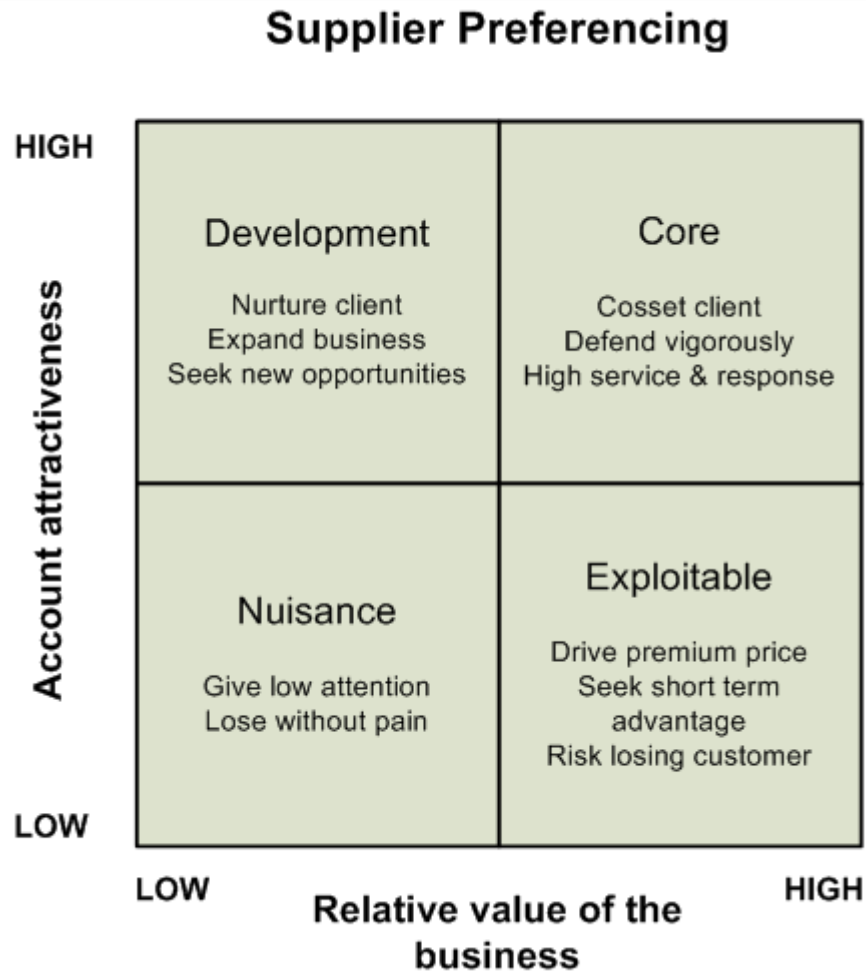


Figure 3.7 Supplier preferencing matrix (Van Weele, 2003)

Another heard regard of Kraljic is that the strategies that are proposed are at a quite rough level (Gelderman & Van Weele, 2005; Virolainen, 1998). The selected procurement strategy that companies use, will differ depending on business strategy, this is covered in chapter 2, the competencies - e.g. the skills of the employees, will be discussed in chapter 4 - and the power of the company (Virolainen, 1998). To be a world-class competitor, the expertise and commitment of the supplier must be used (Virolainen, 1998). Other authors have mentioned that using the expertise and commitment of the supplier is called best value procurement, this form of purchasing will be discussed now.

Best value procurement

Procurement is often characterized by either a more traditional bidding (low-bid) or a best-value structure (Shane et al., 2006). Therefore, despite other procurement methods, these will be the methods that will be discussed in this part of the chapter.

Traditional bidding considers prices as main focus, where the lowest cost proposal is aimed for. The firm provides minimum standards and squeezes the suppliers on discounts (Hans Bax, UMCG). Whilst this approach suggests monetary savings, economic-envisioned end-results or best value are not always reached (Palaneeswaran et al., 2003). This approach could trigger the suppliers to provide unrealistic low bids as well as improperly balanced risk allocation, which

could lead to unwanted economic end-results (Palaneeswaran et al., 2003). Furthermore, the supplier is forced to implement strict cost-cutting measures to comply with the standards set by the firm instead of focusing on quality enhancing measures which reduces the chance of delivery of optimum quality projects (Scott et al., 2006 in Abdelrahman et al., 2008) This is confirmed in practice as Hans Bax (UMCG) states that focus on price will lead to reduction of quality, as is also mentioned earlier in the chapter. Due to all the standards, there is less freedom for the supplier to implement knowledge and expertise to come to the best solution The circles embody criteria from the firm, when more criteria is added, the freedom to find solution decreases leading to focus solely on the standards and failure of deliverance of quality. The figure shows that when an additional standard is added the room for the supplier to come up with solutions is half of what is was before.

The low-bid approach is best to be used in a price-based industry with high competition (Kashiwagi et al., 2004) where the focus is on the best deal for the short term (Koopmans, Adjust). As it is focused on the short term, it will be harder to create sustainable long-term relationships. It is best to link to leverage products as these items provide low supply risk (Koopmans, Adjust; Van Weele, 2010), but are a relatively large share of the price of the end product. Therefore, a minor change in cost has a relatively strong effect in the price of the end product, whilst refraining from taking a lot of risk. Furthermore, leverage products provide room for negotiation and possibilities to switch from suppliers making the short-term and cost-focused nature appropriate for this type of product.

Case Study 3.3: Plus Supermarket

Van Heerde et al. (2008) indicate that on October 20, 2003, Albert Heijn, a Dutch supermarket, decided to severely decrease the prices for more than 1000 products across multiple product categories. Therefore, other supermarkets were forced to lower prices of most of their assortment to stay competitive leading to the so-called price war. Several supermarkets, including the Plus, faced decreases or losses in profit margins. Hence, Plus decided to declaim these losses in margin to the suppliers of these brands forcing them to provide lower prices. This demand for discounts can be seen as squeezing the supplier for the lowest prices focusing on the short term cost benefits creating an environment where the lowest bid will be seen as most beneficial.

Next to this narrow focus on economical aspects and control of the requirements, the best value procurement (also referred to as performance information procurement system or PIPS) exists. Best-value procurement does not solely consider price, but also takes into consideration technical criteria and qualifications (Abdelrahman et al., 2008; Shane et al., 2006) and claims that in order to increase efficiency the need for management needs to decrease contrary to traditional bidding (Sullivan & Guo, 2009). The main vision is to increase the value added for each monetary unit added (Abdelrahman et al., 2008), thus to provide optimal combination of price and performance (Molenaar & Johnson, 2003). As the concept is still fairly ambiguous, there is no commonly agreed definition for value-procurement. However, van de Rijt and Santema (2012) provide a compact description of **best value procurement**, namely that it is a procurement process where “the risk is shifted to the vendors to show value through dominant expertise, knowing that experts minimize both risk and cost, thus providing the best value for the lowest cost” (Van de Rijt & Santema, 2012). Thus, the buyer/client relies on the expertise of the vendor for the highest performance and minimizes technical decision-making and

management by the buyer/client by transferring control and risk to the vendor (van de Rijt et al., 2011). More specifically, the responsibility regarding completion of the project and performance are left to the expertise and experience of the supplier without specification, direction and inspection (Sullivan & Guo, 2009). Solely, the quality assurance is done by the buyer/client, whilst the suppliers controls the quality and manages the risk (van de Rijt et al., 2011). The control of the project as well as the fact that the supplier is set at risk will stimulate the supplier to deliver quality projects (Sullivan & Guo, 2009). Furthermore, the supplier will be rated in the end on performance, which will influence the chance of obtaining work in the future (Sullivan & Guo, 2009).

When applied correctly, the process will reward innovative proposals that increase quality or proposals that provide quality for lower cost (Molenaar & Johnson, 2003) leading to increased quality or a better price-quality ratio. This is confirmed in practice by Hans Bax (UMCG) stating that a focus on quality leads to a reduction in price. Furthermore, management efforts will decrease significantly by 80 to 90 per cent and completion of projects will increase by a tenfold (Kashiwagi et al., 2003; Sullivan et al., 2007) From a supplier perspective, the best value procurement provides the opportunity to maximize their profit by working in an efficient as well as handle projects faster leading to the possibility to handle more project during the same time span (Sullivan & Guo, 2009). However, there is also a significant chance of using best value procurement incorrectly as evaluation of the proposal is proven difficult, especially because there are no standards for scoring proposals (Molenaar & Johnson, 2003). Buyers/clients should base it solely on measurable value-adding aspects to the project (Molenaar & Johnson, 2003) as well as a focus on transparency in plans of both the parties to ensure no information is hidden and diminish the element of subjectivity (Shane et al., 2006). The best value procurement can be linked to strategic products in the Kraljic matrix, as van Weele (2010) states that strategic products should be managed with performance based partnerships. However, in practice, it was more broadly applied, as Ad Weterings (Gasunie) stated that the company uses best value for routine products.

Case Study 3.4: Rijkswaterstraat

The Rijkswaterstaat is in control of the roads in the Netherlands and has a so-called fast track program where 16 major road bottlenecks had to be resolved. They adopted the best value procurement as early adopters in the Netherlands and are the largest best value procurement project in the world with a combined worth of €600 million or \$ 800 million. The Rijkswaterstaat first prepares by defining the project goals and quality criteria. Then dominant information about the project regarding risk and performance is gathered from the supplier leading to the choice of the best expert in the field. This is the supplier who offers most value for the lowest price. The supplier then elaborates on the plans and makes the promised results measurable. This is when the task is allocated officially. The performance of the supplier is then measured with weekly reports.

Movements inside Kraljic matrix

The three strategies (exploit, balance and diversify) are rather generic and only provides rough guidelines. Another disadvantage of Kraljic its approach is that it does not provide guidelines for moving commodities or suppliers around the different categories (Gelderman & van Weele, 2002). Gelderman & van Weele provided some extra guidelines for the different quadrant that do take into account the moving commodities around the different categories, these will now be discussed. The possible strategies that are mentioned by Gelderman & van Weele can be seen in figure 3.9.

Strategy	What is it?	Result
Capacity deal	The purchasing department focuses on one supplier that is the approved supplier. This gives the buying company a better negotiating position.	Bottleneck items can be moved to “better bottleneck items”.
Pooling	Business units agree on standardization, such that the one standard product can be bought instead of different forms of the same product.	Bottleneck or non-critical items move to leverage items.
De-complex	Make the end product less complex, but still match with the needs of the business group or client involved.	Bottleneck items move to non-critical items.
Purchase card	Specific products that cannot be pooled are purchased on a transactional basis.	Non-critical items become even more non-critical.
Strategic partnership	Assessment of the supplier is executed on key buying criteria that are specified by the buyer itself. If trust in the performance of supplier is high enough, strategic partnerships can be considered.	Move leverage items to strategic items. For strategic items: it is recommended to use this strategy.
Partnership of convenience	When a supplier does not qualify as a strategic partner, the focus will be on efficiency and cost reduction.	Leverage items stay leverage items. However, costs can be reduced.
Supplier development	In the case of non-optimal strategic partnership with under-achieving partners, supplier development can help by increasing the quality of the supplier by training.	Strategic items become leverage items.

Tablee 3.9 Possible strategies to move commodities inside Kraljic matrix (Gelderman & van Weele, 2002)

SUPPLIER SELECTION

Purchasing, including sourcing, scouting and selecting suppliers as stated earlier, has developed from a tactical and more operational function to a strategic function, which influence the degree to which a focal organization will be a success or a failure (Goffin, Szejczewski & New, 1997). According to Ellram (1990) the process of purchasing, including selecting and establishing partnerships with external suppliers consists of a five-stage model and corresponds with the purchasing process model of van Weele (2010). The 5 stages of Ellram are:

- Establish strategic needs, form team, confirm top management support
- Identify potential partners
- Screen and select
- Establish relationship: provide high attention level and give prompt feedback.
- Evaluate relationship: continue, expand, or reduce

This section in the book will only focus on the strategic side of point 2 and mainly 3, which is finding and selecting optimal supplier base and the evaluation of the suppliers by different selection criteria. The other stages are either already discussed or will be discussed in the next chapters. Stage 1 is about internal alignment and the make-or-buy decision, which is discussed in chapter 2. Furthermore, stage 4 and 5 is about the relationship and contracting management and will be discussed in more detail in chapter 4.

Sourcing & scouting for suppliers

As already discussed in paragraph 3.3, the process of strategic sourcing can only start when the organizations have determined the importance and potential profits of products, components and services. The different items a company wants to outsource and the potential supply risk is estimated by scaling the goods in one of the quadrants of the already mentioned purchasing portfolio of Kraijlic (1983). When the company knows in which quadrants the different products are, the process of strategic sourcing continues with deciding whether to source for new and unknown suppliers outside the existing supply base. Another option is to choose suppliers, which have supplied the organization in the past or are still supplying. In other words, it is about the decision whether to do a complete new purchase, modified rebuy or straight rebuy (de Boer, Labro & Morlacchi, 2001). Depending on the variables of Kraijlic and the complexity of the goods the buying organizations needs to choose between these 3 options. The differences between the options will be shortly described below (Robinson, Faris & Wind, 1967: de Boer et al. 2001 and Johnsen et al. 2014 and):

- *New purchase:* This situation occurs when an organization starts with a complete new product, component or service. The organization has not purchase goods in this area of the supply market before and therefore needs to walk through the whole purchasing process again and decide from which supplier they will buy the new product or service. This takes a lot of time and effort to establish and the uncertainty and chance of disruptive events are relatively high.
- *A modified repurchase:* In this situation the organizations decides either to buy the new product, component or service from a supplier the organization already knows and worked with before or scout for a completely new supplier. In addition it is also possible that in the case of a modified rebuy that the buying organization bought a good from a

certain supplier in past, but decides not to purchase from anymore because the characteristics of the product have changed or a negative evaluation of the supplier.

- *A straight rebuy*: In this case the organization buys an existing product, component or service from a known supplier. Costs such as transaction costs can be kept low and the level of risk and uncertainty is low due to the fact the purchase is from a repetitive nature.

In figure 3.10 the relation as described above, about the newness of the goods and the supplier and the level of risk and uncertainty this involves is shown. Nowadays most organizations are aware that scouting and selecting new suppliers is a costly and risky investment and having a supply base which have shown to be trustful, reliable and long-term relationship are therefore in most cases preferred. (Johnsen et al., 2014). In paragraphs below the complexity and the importance of the composition of the supply base and the selecting criteria will be further discussed.

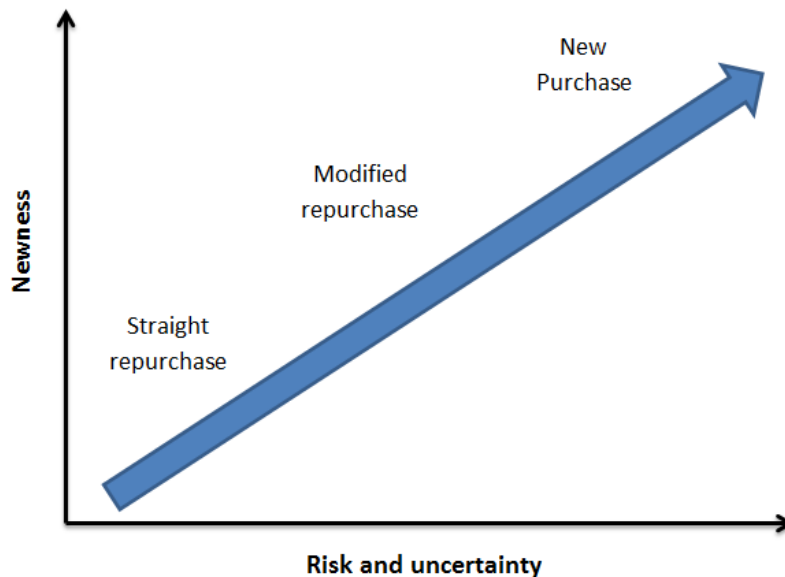


Figure 3.10 New, modified and straight repurchase (Johnsen et al, 2014).

Supplier base

“**Supply base** is a definition of the part of supply network which is actively managed and controlled by the buying company” (Choi & Krause, 2006: 636). This means that the focal organization manage, controls and buy from the suppliers on the supply side, including both suppliers directly and indirectly linked to the focal organization. The schematic representation how the focal organization is related to first-tier (directly linked) and second and third-tier suppliers (indirectly linked) is shown in figure 3.11 (Choi & Krause, 2006). In the drawing the blue lines indicate the partnerships of the first tier supplier with second and third tier suppliers. For example is it possible that second or third tier suppliers that are contracted by the focal company will not directly deliver their goods or services to the focal organization but instead to other suppliers in the supply base before it reaches the focal organization (Choi & Krause, 2006).

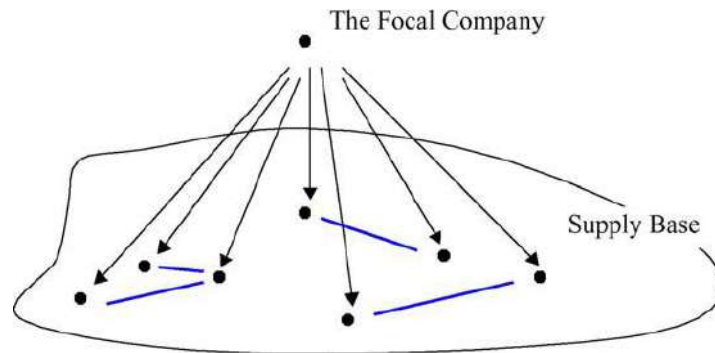


Figure 3.11 Supply base (Choi & Krause, 2006)

To manage and control the suppliers the focal company, contracts must be concluded with the suppliers about purchasing products, components, raw materials and services. According to Choi and Krause (2006) the complexity of the supply base is an important managerial aspect, which includes 3 dimensions that needs to be considered by the focal organization:

- The number of suppliers in the supply base.
- Degree of differentiation among these suppliers.
- Level of relationships among the suppliers.

Due to the increased search for lower costs and higher quality nowadays, purchasing organizations expand their scope to outsource and purchase different goods all around the world. The result is that the complexity of the supply base has become even more difficult to manage for most focal organization. The global nature of trading have made it for the buying organization critical to take the supply base complexity dimensions of Choi and Krause (2006) very seriously in order to compete in the highly competitive global markets (Parmar et al., 2010). Furthermore, the complexity and composition of the supply has major impact on the focal organization and affect the height of the (transactions) costs, the degree of supply risk, suppliers responsiveness and the degree the focal organization perceives the supplier(s) as innovative (Choi & Krause, 2006). For instance the smaller the number of suppliers and the closer the relationship the more it reduces the potential of risk, the negotiation costs and stimulates the supplier to be innovative (Johnsen et al, 2014). Therefore it is an essential to take these dimensions into account in the strategic supplier selection (Choi, Dooley & Rungtusanatha, 2001).

The supply base includes the number of suppliers where a focal organization buys from and the degree the characteristics suppliers differ with respect to the focal organization. Other new suppliers need to be taken into consideration when selecting suppliers. Due to the trend of outsourcing globally, the focal organization needs to take in account the different environmental and cultural circumstances and differences of the suppliers and need to assess the potential risks of those suppliers (cousins & Semeijn, 2006). This means that a certain skill is needed, this will be discussed in chapter 5. According to Goffin, et al. (1997) the more suppliers you have and the more they differ from each other, the more complex it is to manage and control the partnership. This is caused due to the fact that suppliers are more involved nowadays in the new product design process and the decision-making about how to reduce costs or improve quality of products or services. Therefore many different suppliers with different influences and backgrounds are impossible to manage for most of the buying organizations. Furthermore it is necessary that the focal organization reduces and optimizes the number of suppliers and buys higher quantities from only a few suppliers in order to reduce unnecessary (negotiation) costs and to be competitive (Choi & Krause, 2006).

However, according to Cousins (1999) when the focal organization decides to reduce the supply base, the focal organization must be aware that the management style needs to be more strategically focused. For instance by reducing the supply base to only one or a few suppliers, there is a potential risk that the supplier(s) have the upper hand in the negotiations and decisions. This should be avoided by focal organization at all cost (Burke, Carrillo & Vakharia, 2006). Therefore strategic elements such as coordination, cross-functional work, clear agreements and close collaboration of the focal company with its supplier(s) is needed in order to not lose the bargaining power in partnerships with only a few suppliers. Thus, is it important that the focal organization develops new skills and competences in order to have a healthy partnership (Cousins, 1999). The influence the number of suppliers has on the focal organization will be discussed more in depth in the next paragraph and topics such suppliers relationship, contracts and required purchasing skills will be discussed further in chapter 4 and 5.

SINGLE VS MULTIPLE SOURCING

The number of suppliers is related to the decision whether the organizations will follow the single or multiple sourcing strategies. A focal organization does not only have to decide about the number of suppliers it wants to purchase from, but also needs to assess which influence this decision has on the probability of risk and what consequences this could have for the organization, for example financially (Constantino & Pellegrino, 2009). All the advantages and disadvantages of single and multiple sourcing are shown in figure 3.12 (Costantino and Pellegrino 2009).

	Single Sourcing	Multiple Sourcing
<i>Advantages</i>	<ul style="list-style-type: none"> • Partnership between buyers and suppliers allows cooperation, shared benefits and long-term relationship based on high levels of trust. • Reduction of risk of opportunistic behavior. • Large Commitment of the supplier that is willing to invest in new technology or new facilities. • Lower purchase prices resulting from reduced production costs, due to better knowledge of the manufacturing process by supplier and achieved economies of scale. 	<ul style="list-style-type: none"> • Alternative sources of materials in case of delivery stoppage by a supplier. • Reduced probability of bottlenecks due to insufficient production capacity to meet peak demand. • Increase competition among suppliers leads to better quality, price, delivery, product innovation, and buyer's negotiation power. • More flexibility to react to unexpected events that could endanger supplier's capacity.
<i>Disadvantages</i>	<ul style="list-style-type: none"> • Great dependency between the buyer and the supplier. • Increase vulnerability of supply. • Increased risk of supply interruption, especially for asset specific products. 	<ul style="list-style-type: none"> • Reduced efforts by supplier to match buyer's requirements. • Higher costs for the purchasing organization (greater number of orders telephone calls, records and so on).

Table 3.12 (Dis)advantages of Single & Multiple sourcing strategies (Costantino & Pellegrino, 2009)

The concept of single sourcing evolved since the Just in Time (JIT) and lean philosophies were introduced and is characterized by long-term and closely related partnership with only one or a few suppliers (Costantino & Pellegrino, 2009). Both the focal organization and the supplier(s)

are striving for mutual benefits in a highly cooperative manner. This creates an environment where the suppliers is stimulated and assisted to deliver high quality products, to invest in new technologies to ensure production and partnership in the future (Sarkar, Mohapatra, Chaudhary, Agrawal, Mandal & Padhi, 2012). Lower prices are obtained with single sourcing due to the fact the local organization purchase higher quantities from one or few suppliers (Johnsen et al., 2014). However due to the high reliability of the focal organization of only one or a few suppliers, these organizations are more vulnerable in a case disruptive events occur than with multiple sourcing. This could lead to the inability to meet the demand and associated catastrophic financial losses where a focal organization possibly cannot retrieve from (Johnsen et al., 2014).

In a multiple sourcing strategy a focal organization decides to purchase the same products, components or services from multiple suppliers (Johnsen et al., 2014). Multiple sourcing is characterized as short-term focused and less collaborative than single sourcing (Goffin et al., 1997). Suppliers are competing with each other to get the order, which leads to low prices for the focal organization and if necessary the focal organization is able to switch between suppliers, this can be useful in the non-critical quadrant of Kraljic its matrix. By using this way of sourcing the risk is spread in case something happens to suppliers and therefore the company is always able to meet the demand (Sarkar et al, 2012). Risk prevention is the main reason to choose for multiple sourcing, especially due to the global orientation of focal organizations (Sarkar et al, 2012).

Case Study 3.5: Negative examples of single sourcing

Sarkar et al. (2012) summarized some examples where different leading car-manufactures suffered from mismanagement involving choosing a single sourcing strategy instead of spreading the risk by multiples suppliers.

Toyota: In 1997 Toyota had to close 20 from the total of 40 assembly lines for 6 weeks because of a major fire at one of the key suppliers of brake-fluid adjusting valves. Due to this catastrophic event and the shutdown of 20 assembly lines, Toyota was only partly able to meet the demand and which lead to estimated losses of 40 million dollar a day.

Rolls-Royce: As many other leading organizations, Rolls-Royce decided to reduce the supplier base by half. This reduction resulted that Rolls-Royce was not able to react flexible to new demand chances and customers' requirements.

Land Rover: The bankruptcy of a major supplier of chassis parts forced Land Rover to delay the production for a more than 8 weeks due to the search for a new supplier

Despite the clear (dis)-advantages of both single and multiple sourcing and reducing the supply base is necessary to stay competitive, many authors do not agree whether just only the single or multiple sourcing should be used (Chen, Paulraj & Lado, 2004; Johnsen et al., 2014; Sarkar et al., 2012). Even though many leading organization see single sourcing as the best alternative, according to Chen, et al. (2004) a single sourcing strategy does not always contributes to quicker customers responsiveness, reduced costs or improved product quality in a global and high competitive environment. Insufficient amount of suppliers could lead to higher costs, lower quality of product, incapability to meet the demand and react to disruptive events.

Manners-Bell (2014) stated that multiple sourcing is seen, in a world of globalization, as an effective way to prevent the focal organization of disruptive events at the suppliers (Manners-Bell, 2014). According to Lee & Wolfe (2003) most suppliers are much more flexible and effective to meet demand changes nowadays. It is therefore not always necessary to have only close and long-term partnership with supplier(s). While on the other hand, Johnsen et al. (2014) and Choi & Krause (2006) believe that due to the global nature of trade the supply base should be reduced in order to be able to manage the complexity in the continues changing markets, customer requirements and environment. Thus, just a decision between single or multiple sourcing strategy is in some case insufficient, but an optimal composition of the supply base, depending on the circumstances of both the suppliers and the focal organization could be a serious option for many focal organizations (Choi & Krause, 2006). In case 3.4 on the previous page examples are shown of different companies who suffer tremendously because of partnership with insufficient amount of suppliers.

Selection criteria

After the focal organization has determined which goods it wants to outsource, the importance of the goods to the organization, the newness and complexity of these goods, the required number of suppliers and the degree suppliers differ from each other, the organization needs to decide on which criteria it will select the suppliers. These criteria are used to reinforce and improve the selection process (Vonderembse & Tracey, 1999).

Different researchers disagree on whether focal organizations should use a more traditional criteria approach for selection suppliers or choose for the new modern approaches (Ming, Chiang & Lan, 2008). The traditional approach is based on the trade-off between the price, costs, quality and speed of delivery Price, costs, quality and delivery performance of suppliers. The traditional criteria are still fundamental criteria to make a solid judgment about suppliers according the authors Verma & Pullman (1998) and Xia & Wu (2007). However Sarkis and Talluri (2002) stated that selection of suppliers mainly based on cost or quality is no longer acceptable in today's complex and globalized world. Therefore modern approaches that also keep the dynamic and competitive environment in account are needed. The current trend that leading organizations are mainly focusing on long-term relationship with only one key or few suppliers creates an increase in dependency on those suppliers. These factors should be evaluated even more carefully before the buying company can select a suitable supplier (Ming, Chiang & Lan, 2008).

The modern approaches are looking in more detail at the specific costs such as transaction, transport and inventory costs. Furthermore also the capabilities, financial situation and environmental record of a supplier are taken into account. Furthermore, most criteria are based on only quantifiable measures, while qualitative factors such as the culture of the focal organization can cooperate with the culture of the supplier should be taken into consideration as well (Goffin et al., 1997). Nevertheless, it is essential that the buying organizations still receive the products, components or services for an acceptable price in the right quantity. Therefore, these traditional criteria should not be forgotten (Sarkis & Talluri, 2002). Saunders (1994) states that traditional criteria are more suitable for short-term relationships and multiple sourcing strategies. On the other hand, too many different criteria will make it complex instead of efficient and effective selection of suppliers (Ming-Lang et al., 2008). The criteria formulated by Kahraman, Cebeci and Ulukan (2003) and Saunders (1994) make use from both the traditional and modern criteria and is a good starting point to evaluate different suppliers. These criteria are as follow:

- *Financial*: The financial stability and strong economic performance in the past is needed for every form of partnership, especially long-term and trustful relationships. This way continuity and reliability of the partnership is secured and performance standards, the quality and the delivery of goods can be maintained.
- *Organizational culture and strategy*: With this criterion is meant that both parties share the same values and views towards the future. They perceive mutual trust and there is a strategic fit between both the focal organization and the supplier. Besides the degree of education & training, safety records, working environment for employees, supplier infrastructure, location of facility and legal circumstances are fields where the buying organization will look into as well. Especially in a global market where the suppliers around the world differ quite significantly on these matters. Furthermore, the global market is controlled by the international laws and regulations.
- *Technical capabilities*: The suppliers should have the capabilities to provide a continuous and consistently flow of products, components and services according to the agreed level of quality, quantity, price and delivery. Furthermore the ability of the supplier to meet the necessary future improvements, design changes and the speed in development are important aspect of the technical criteria. In case of a new purchase an ability to develop innovative and unique technology could be a criteria as well.
- *Support resource*: The supplier its resources need to be adequate to support product or service development production and delivery. Criteria need to consider the supplier its facilities, information systems and provisions for education and training. When considering international suppliers, a firm needs to carefully examine the industrial infrastructure that supports the supplier. With international suppliers, a firm also needs to establish appropriate mechanisms to handle financial transactions and product deliveries, as well as any related legal or regulatory matters.
- *Risk involving globalization and localization*: The buying organization should examine the advantages or disadvantages of local and global suppliers. Moreover, this includes potential different forms of risks or disruptive events occurring for specific suppliers in different locations. There should be decided whether these risks can be mitigated, the change of occurring and whether advantages for a specific supplier and location weigh more than these potential risk. The assessment and evaluation of the risk is unfortunately beyond the scope of this book.

CONCLUSION

Concluding this chapter, the purchasing function of a company clearly changed from a clerical buying function to a strategic business function that is integrated in the company. Managing the products and supplier relationships is therefore important. (Gelderman & Van Weele, 2005) Managing the products is covered in this chapter. The management of relationships will be discussed in the following chapter. Since this change, purchasing is a strategic part of the company and therefore strategic decisions should be made regarding the products.

In strategically managing the products, portfolio models can be used. The one that is covered in this chapter is the Kraljic matrix, developed by Peter Kraljic in 1983 (Kraljic, 1983). After the success of Kraljic its matrix, other forms of product portfolio models are developed by several scholars (Gelderman & Van Weele, 2005). These portfolio models can give an insight in which strategy to use, whether to use single or multiple sourcing, best value procurement or the more traditional way of sourcing, near-sourcing or global sourcing. This should all be linked to the other internal business departments, which is covered in chapter 2.

The use of single or multiple sourcing and the position of the companies over the world affect the supply base (Constantino & Pellegrino, 2009). This can be very complex by having multiple suppliers all over the world or be rather simple by having one supplier nearby. All these factors should be taken into account in the strategy that is chosen for certain products in the four quadrants of Kraljic: non-critical, bottleneck, leverage or strategic items.

Although, Kraljic is used by many purchasers, it has also different disadvantages: quite rough and not precise strategies and no strategy that can be used to move inside the Kraljic matrix from quadrant to quadrant (Gelderman & Van Weele, 2005).

In the next chapter the relationship between buyer and supplier is discussed. The relationship has also influence on the strategic decisions a company should make, since the power can be distributed at the buyer or at the supplier (Caniëls & Gelderman, 2005).

FUTURE SECTION

In the last couple of years the procurement department changed from a supportive function in a company that has as only goal to purchase items as cheap as possible, to an integrated function that can add value to the department (Gelderman & Van Weele, 2005). In the (near) future, strategic purchasing will become more popular, due to the fact that procurement is the place where money can be earned. Since, around 50% of a product is purchased from other companies. Thus, for around 50% of the product price is spend by the procurement department. In the (near) future this will result in a procurement strategy that is more focused on the long-term benefits (Su, Dyer, & Gargeya, 2008). Where in the current situation some procurement departments are squeezing on the discount to lower the price.

Also sourcing strategies as Best Value Procurement will take a run (Bax, UMCG). More and more companies probably want to try the success story Best Value Procurement. This will result in trusting the suppliers, without being naïve. However, to know where the border is between trust and naivety will be hard to recognize. This will result in some situations where trust becomes naivety, resulting in a wrong procurement.

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Chapter 4

SUPPLIER RELATIONS & CONTRACT MANAGEMENT

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Abstract:

Supplier Relationships and Contract Management are essential in the process of strategic purchasing. This book chapter focuses on the essence of supplier relationships in a global purchasing environment. All aspects of Supplier Relationships and Contract Management including relationship management, contract management, supplier involvement and the key drivers and barriers of relations in strategic purchasing are addressed. The globalization of strategic purchasing asks for decisions concerning the management of relations between buyers and suppliers.

Key words:

- **Relationship Management**
- **Supplier Networks**
- **Contract Management**
- **Supplier Development**
- **Supplier Involvement**

INTRODUCTION

In strategic purchasing one of the aims is to minimize the amount of suppliers. With these suppliers a long-term relationship is the goal. To be able to maintain and control long-term relationships, supplier relationship management is necessary. In this chapter the management of the suppliers will be discussed from just dyadic relationships till complex global supply networks. To make long-term relationships work, organizations often involve the supplier in different organizational processes, and also the other way around. The involvement of suppliers can be crucial to make supplier relationships successful. After the development and the involvement of suppliers, contracts are signed. But this is not where it ends for the purchasing department concerning the contact with the supplier. After the signing of the contract the contract needs to be managed, also called contract management. Contract management concerns the monitoring and evaluation of suppliers in the purchasing activities. Not all relationships with suppliers work as planned, this can be caused by several aspects, such as cultural differences, trustworthiness of supplier, etc. Especially with the globalization of the purchasing processes relationships are harder to maintain. This will be discussed in the drivers and barriers of supplier relations.

SUPPLIER RELATIONSHIP MANAGEMENT

The globalization of markets, the complexity of products, diversification of customer needs and efficient supply management influence the competitiveness of firms. Efficient supply chain management demands a well-organized and performing purchasing function as the costs of purchasing and outsourcing comprise a larger part of the total costs of the manufacturing process (Park et al. 2006). Therefore, supplier relationship management has become increasingly important in the environment of today. **Supplier relationship management** “is the process of engaging in activities of setting up, developing, stabilizing and dissolving relationships with in-suppliers as well as the observation of out-suppliers to create and enhance value within relationships” (Moeller et al, 2006, p. 73). Trent (2007) argues that it is important to build a set of sustainable supplier relationships instead of switching continuously between them. Switching between suppliers was a commonly used practice back in the day; today increased competition and cost pressure in the sales markets require sustainable supplier relationships (Krause et al., 2001). After supplier selection, organizations should immediately switch to supplier relationship management. “Firms can achieve a competitive advantage by focusing on long-term rather than short-term buyer–supplier relationships with key suppliers of the firm” (Carr and Pearson, 1999, p. 514). Key suppliers are extremely important to organizations, they create value through their deep knowledge of the supply market, prior experiences and early involvement in developing new products (Carr and Pearson, 1991; Ulaga & Eggert, 2006) Therefore, it is important to maintain a healthy relationship with suppliers to develop a sustainable competitive advantage. Buyer-supplier relationships can emerge in different structures. Today, not only the direct suppliers are important but also indirect supplier relationships and the relationship among suppliers. Supply networks currently play an important role in how the strategic purchasing is organized. Harland (1999) has defined 4 different kinds of buyer-supplier relationships (see figure 4.1).

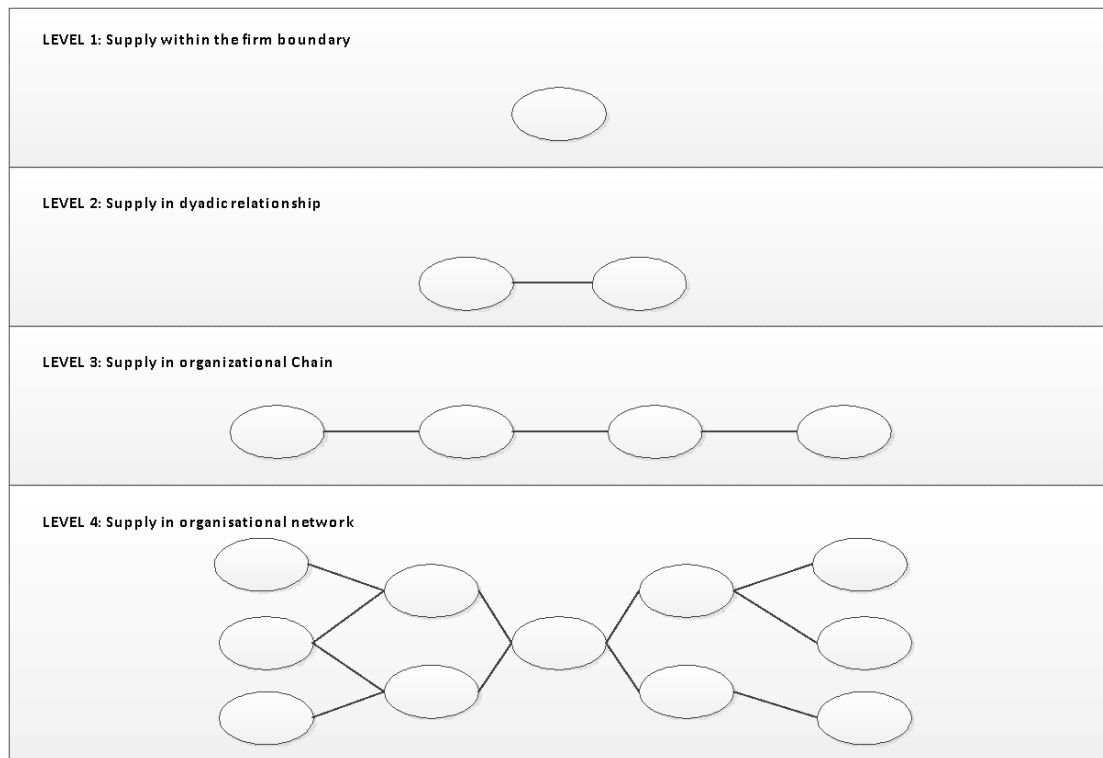


Figure 4.1: Supply networks (Harland, 1999)

Level 1 defines only the supply within the firm, here no suppliers are involved. Level 2 encompasses the Dyadic relationship between buyer and supplier; this is the most concrete relationship in the purchasing process. Level 3 shows the supply of the goods from the perspective that before a product will arrive at the customer; it has been along several steps (suppliers) from raw material to the final good in a supply chain (Harland, 1999). Organizations should maintain a relationship with these second and third-tier suppliers to establish a reliable purchasing process. Level 4 defines the supply in an organizational network of suppliers and buyers. This organizational structure defines the complex structure of multiple relationships between suppliers and buyers, from the raw materials to the final end customers (Lambert & Cooper, 2000). Due to the globalization of supply networks, purchasing activities have become more complex, this asks for a strict relationship management. The following sections will cover the levels of the Harland (1999) model in more detail.

Central in supplier relationship management is the social capital theory that acknowledges the value and value creation of social structures like relationships, networks, groups and individuals (Wagner, 2011). Many scholars argue that organizations gain access to and leverage resources residing in their relationships through social capital (Autry and Griffis, 2008; Cousins et al., 2006; Cousins and Menguc, 2006; Krause et al., 2007; Lawson et al., 2008; Min et al., 2008 in Villena et al., 2010) Also, social capital reduces conflicts and enhances collaborative behavior through the creating a shared vision, trust and social ties. Consequently, they can lead to both operational and, more important, to strategic benefits for organizations. Social capital can be divided in 3 different forms (Villena et al., 2010, p.562):

- Cognitive (e.g., shared culture and goals),
- Relational (e.g., trust, friendship, respect, and reciprocity)
- Structural (e.g., social ties)

All 3 forms can influence outcomes and performance in different ways. However, there are also downsides of social capital, which could reduce the flexibility to adapt to the changing needs of the market. If social capital accumulates, several negative factors could occur: loss of objectivity, risk of opportunism, ineffective decision-making, costly investment compared to the gains which could ultimately danger the buyers performance.

The remainder of this section will discuss the various supply networks mentioned in figure 4.1. We will start with dyadic relationships, the change in buyer-supplier relationship perception and classify supplier relationships. Then, the organizational chain and the organizational network will be discussed through buyer-supplier-supplier relationships.

Dyadic Relationship

Before the late 1970s, scholars saw purchasing as only a transaction between companies, neglecting the fact that long-term relationships can develop over time and create a sustainable competitive advantage. The Industrial Marketing and Purchasing (IMP) group changed the perception of buyer-supplier relationships completely in the late 1970s and 1980s, they recognized the importance of social interactions and developed the interaction model that goes beyond the action-reaction view of that time (Johnsen et al., 2014). Håkansson was part of the IMP group that developed the interaction model, which is “based on continuous ‘exchange relationships’ occurring between a limited number of identifiable actors” (Håkansson and Snehota, 1990 in Johnsen et al., 2014, p. 108). Figure 4.2 shows a simplified version of the interaction model, where the long-term adaptations are aligned with practices of today. The model divides transactions in short-term and long-term exchanges. Short-term exchanges contain goods, services, social exchange, financial exchange and information. Long-term exchanges can include strategic alignment of buyer and supplier, risk and reward sharing or compliance in sustainability strategy. “The model distinguishes between short-term exchanges and long-term exchanges within relationships that institutionalize and adapt to each other” (Håkansson, 1982 in Johnsen et al., 2014, p. 109). **Institutionalization** refers to the fact that processes become routinized and systematized over time (Johnsen et al., 2014). The long-term adaptations influences relationships because they are highly specific to the buyer-supplier relationship and are useless in regard to other relationships. Institutionalization and adaptation may result in blurring boundaries between buyer and supplier (Johnsen et al., 2014, p. 109). This implies that buyer and supplier show strategic resemblance with each other over time, which in turn will improve the relationship.

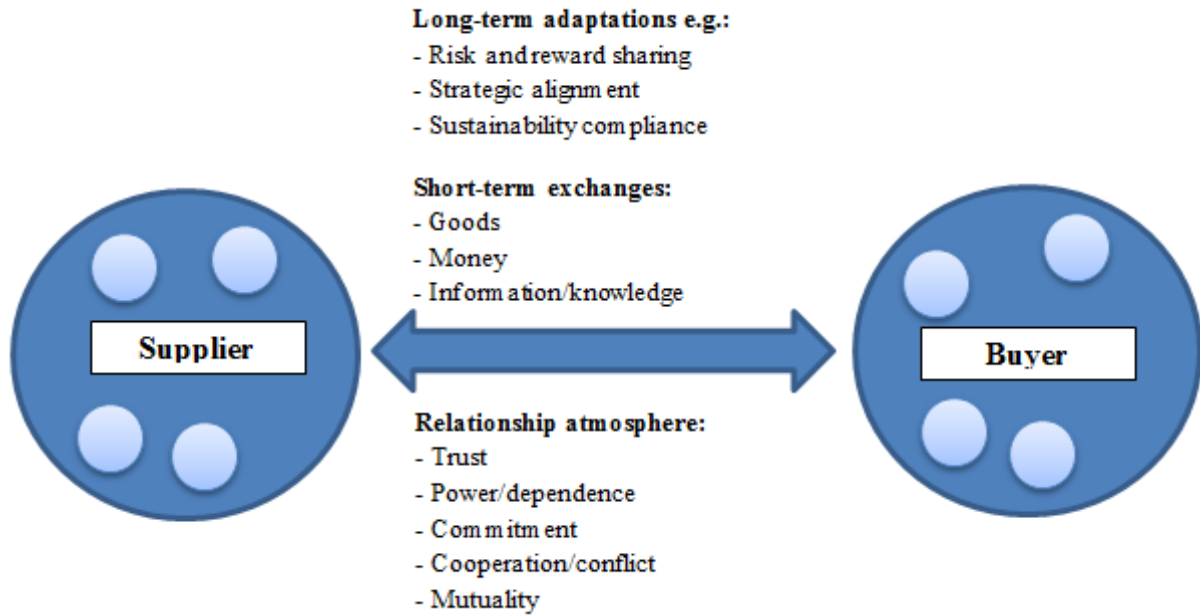


Figure 4.2: The interaction model (Johnsen et al., 2014)

The interaction model divides transactions in short- and long-term and highlights the importance of long-term adaptations for the buyer-supplier relationship. However, it only distinguishes between relationship lengths, but it does not describe and classify buyer-supplier relationships in detail. On top of that, not all short- and long-term suppliers are the same or equally important to the buying firm. The next section will elaborate further on these issues by classifying buyer-supplier relationships.

Supplier Classification

Trent (2007) developed a framework that describes these different buyer-supplier relationships, called the four C's of supplier relationships. This framework creates a stronger and deeper understanding of relationships between the buyer and suppliers, which is vital for effectively managing them. The four C's can be divided into 2 groups: Transactional relationship (counterproductive relationships & competitive relationships) and Collaborative relationships (cooperative relationships & collaborative relationships).

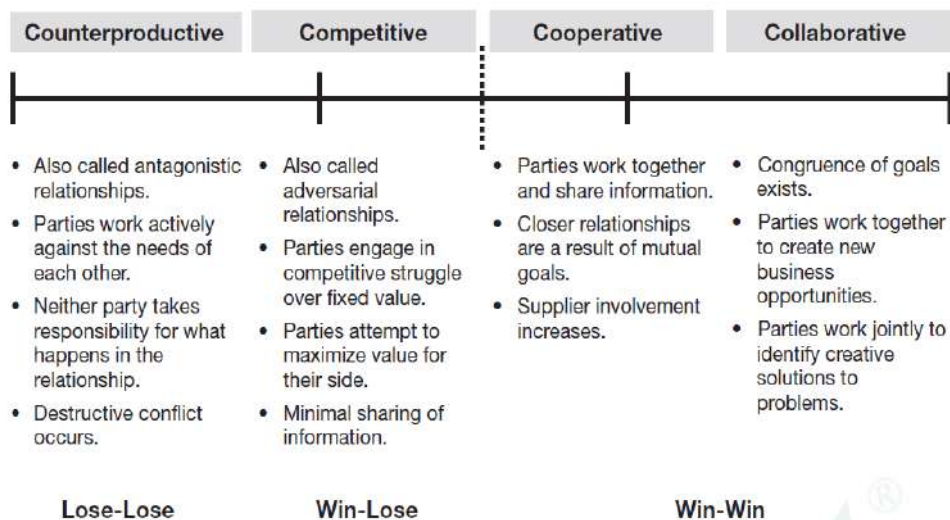


Figure 4.3: The four C's of supplier relations (Trent, 2007)

Counterproductive relationships are characterized by a lose-lose situation, where buyer and supplier are working against each other. These relationships are highlighted by short-term focus, conflict and nobody takes responsibility for whatever happens in the relationship. “This scenario not only fails to create new value, it is detrimental to short and longer-term success” (Trent, 2007, p 117). Langfield-Smith and Greenwood (1998) characterize counterproductive relationships as buyer controlled, constant search for price reductions by threatening to change supplier or actually changing supplier and poor information sharing. Buyers and supplier only trade when they can gain as much as possible from every transaction. They see themselves operating in two different industries. Case 4.1 highlights the fact that counterproductive relationships do not improve, or even reduce competitiveness of firms in various areas, in this case the key areas of the British automotive industry (quality, design and delivery).

Case Study 4.1: Counterproductive buyer-supplier relationships in the UK automotive industry

During the 1970's, the automotive market in the UK was characterized by intensified competition because the demand plummeted and the design of cars switched to smaller, more fuel efficient models. The complete industry was battered by excess capacity. On top of that Japanese automotive firms began increasingly exporting low cost, high quality vehicles to the UK. This caused a mounting pressure on operating conditions and buyer-supplier relationships. Furthermore, prices of energy and raw materials were rising as well at the moment that organization was looking for cost reduction. Consequently, automotive firms were trying to reduce the costs of components through using their market power demanding lower prices for their parts and assemblies, which started a price war among several suppliers. Many suppliers were squeezed from both sides, from one side the automotive firms and from the other side their own supplier that would not accept lowering their prices. The plummeting demand, growing import and lower production volumes led to fluctuations and, in some cases, disappearance of demand for components which in turn lead to bankruptcy or liquidation of suppliers.

Automotive firms also began to see the advantages of multi sourcing especially in cases where little or no investments were required. This increased the pressure on prices even further and ensured supply in an increasingly troubled buyer-supplier relationships environment. Multi sourcing also reduced the production volumes at supplier, which did not contribute to the relationships. Information sharing dropped and automotive firms would not share their building plans that could reduce their negotiation power. “This relationship proved to be both counterproductive in the long run and did little to improve the competitiveness of the British car industry in the key areas of quality design and delivery” (Turnball et al., 1992). In the end, automotive firms from the UK could not offer competitive prices and delivery performance and quality got worse.

(Turnball et. al., 1992)

Competitive relations are win-lose relationships. Buyer and supplier only focus on their own profitability and compete for existing value instead of creating new value. Trent (2007) states that most buyer-supplier relationships should be competitive. It is argued that “the total value of the goods and services provided by these suppliers usually does not make up a majority of total expenditures” (Trent, 2007, p. 118). In competitive relationships, the buyer profits the

most because he can demand price reductions without compensating supplier by exploiting the purchasing leverage (Choi and Wu, 2009). This could lead to a hostile attitude of the supplier, which reduces investments in resources at the buyer. There are, as is shown in figure 4.3, two win-win relationships: cooperative relationships and collaborative relationships. Cooperative relationships are characterized by close interaction between buyer-supplier, long-term focus (long-term contracts) and there is a culture of open information sharing. There is a continuous interaction between buyer and supplier about how to improve performance (e.g. quality, costs, packaging and inventory management). Suppliers are often included in the process of new product development. Dialogues resolve conflicts and both parties see business exchanges as equitable (Walster, Walster and Berscheid 1978; Hatfield, Utne and Traupmann, 1979 in Choi and Wu, 2009). Finally, organizations with collaborative relationships have a very limited supply base that accounts for the vital products and services because these relationships require lots of resources and commitment. Buyer and supplier both want to improve current operations and compete in the marketplace, the collaboration is very intensive. These relationships are characterized by joint strategy development sessions, executive-to-executive interaction and sharing of resources (Trent, 2007). Collaborative approaches lower operating costs and acquisition through this joint effort (Kalwani and Narayandas 1995; Noordewier, John, and Nevin 1990 in Cannon and Homburg, 2001). Both relationships have more trust between the buyer and supplier, later in this chapter trust will be elaborated extensively. Buyer-supplier relationships should not always be collaborative because they, like mentioned before, require lots of resources and commitment. On top of that, there could even be diminishing returns in investments between entities in a supply chain in collaborative relationships (Das et al., 2006 in Leeuw and Fransoo, 2009). Furthermore, it is perfectly acceptable that firms perform arm's length transactions when the situation is appropriate (Spekman et al., 1998). In this context, the degree of criticality of the supplier is important. This is the way the buying firm views the supplier as a critical factor for success. Also strategic importance to the firm and complexity are factors that determine the buyer-supplier relationship selection. "Complexity can be financial (i.e. a significant dollar commitment) or commercial (e.g. intertwined and/or interdependent technology, joint production processes, shared development)" (Spekman et al., 1998, p. 648). If strategic importance and complexity are low, buying firms would use open market negotiations to press prices and get the best deal, competitive relationship are common in this context. While collaborative relationships are used when strategic importance and complexity are high. Cooperative relationships are often used in situations where strategic importance is low but complexity high (Spekman et al., 1998). Like stated before, counterproductive relationship are never desirable. Leeuw en Fransoo (2009) states that characteristics of the market, product and partner influence the decision which buyer-supplier relationship to apply in a specific context. There is no "one size fits all" combination that characterizes a specific relationship. It is however important that organizations reduce uncertainties and exploit opportunities within their supply base by identifying which suppliers creates the most value and leverage their capabilities throughout the entire supply chain (Spekman et al., 1998).

This paragraph highlighted the level 2 network of Harland (1999), the dyadic relationship between suppliers and buyers, which is the most active relationship within the purchasing departments. The next paragraph will highlight the supply network levels 3 and 4. Within these levels the purchasing department will have to look further than just the first-tier supplier.

Supply chain networks

Level 3 defines the supply in the organizational chain (figure 4.4). In the organizational chain there are a couple of suppliers who deliver to each other, before the end product is being delivered at the purchasing party.

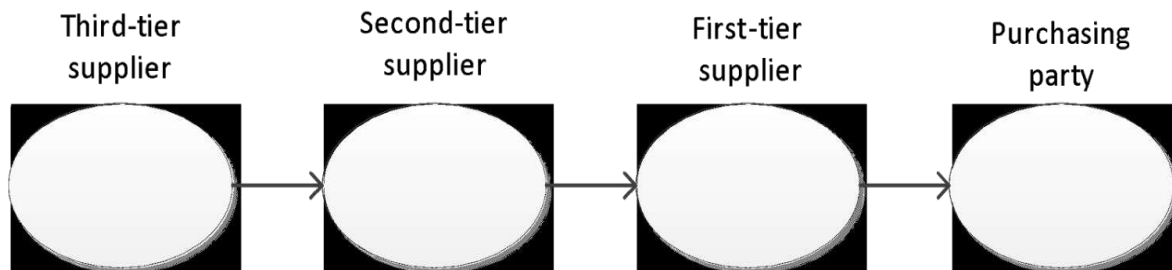


Figure. 4.4 Supply in inter-organizational chain

As for example, when a purchasing party orders from the first-tier, the ordered products are manufactured by the first-tier supplier. But the parts used by the first-tier supplier, can be produced by the second tier-supplier. And this can go further to the third-tier supplier and so on. For the purchasing party it is also important to maintain relationships with their second and third tier suppliers. When a second/third-tier supplier falls out of the chain, this will affect the purchasing party. They will not get their goods, because the first-tier supplier will not have the materials to produce the goods (Kull & Closs, 2008). Consequently, the reliability of the other suppliers in the chain is of great importance. A good example of the importance of maintaining relationships with the other suppliers in the chain is to know where your goods come from. Take for example the chocolate producers; they buy their cacao from suppliers, without considering how this cacao has been retrieved. While often there is child labor involved. This could harm the image of the organization. However there are also some chocolate suppliers who are involved from the retrieving of cacao till the selling of the chocolate (Nkamleu & Kielland, 2006).

Level 4 is the supply in inter-organizational networks; these are complex networks of suppliers and buyers, which interact with each other (Harland, 1996). A good description of **supply networks** was given by Harland et al. (2001, p. 22): “Supply networks are nested within wider inter-organization networks and consist of interconnected entities whose primary purpose is the procurement, use, and transformation of resources to provide packages of goods and services”. While strategic purchasing aims at limiting the amount of suppliers (Cheng, 2004), it is often inevitable to have more than one supplier. It is rare for a firm to have just one dyadic relationship; most firms have a supply chain that looks like a rooted tree with branches and roots. Those branches and roots represent the extensive networks of suppliers and customers ((Lambert & Cooper, 2000). These extensive networks operations occur often outside national borders, and extend worldwide. For those operations that extend the national borders often long-term alliances are developed with a small core group of suppliers; which is in line with strategic purchasing. The purchasing functions develop communication mechanisms like EDI and ERP, such that orders are placed automatically, and that the purchaser can put their focus on managing their relationships with their suppliers (Lambert & Cooper, 2000.)

Several kinds of buyer-supplier relationships are discussed in the previous paragraph. It described dyadic and network relationships, showed the changed perception on the buyer-

supplier relationships and classified them. The next section will discuss how suppliers could be involved in organizations.

SUPPLIER INVOLVEMENT

Good supplier relations might lead to involving the supplier in the organization, but also the other way around. Supplier involvement is all about involving the supplier in different organizational processes. The topic has gained much interest lately because of the benefits it can have for companies by increasing effectiveness and efficiency (Wynstra & Pierick, 2000). **Supplier involvement** is defined by Echtelt, Wynstra, van Weele, & Duysters (2008, p. 182) as “the resources (capabilities, investments, information, knowledge, ideas) that suppliers provide, the tasks they carry out and the responsibilities they assume regarding the development of a part, process or service for the benefit of a buyer’s current or future product development projects”.

As (Dowlatshahi, 1999, p.4119) states: “**ESI (Early Supplier Involvement)** has been advocated as means of integrating suppliers’ capabilities in the buying firm’s supply chain system and operations (Dobler and Burt 1996).” The concept of supplier involvement is about exchange relationships between the buyer and supplier, this exchange relationship depends on the extent of the involvement of the supplier in co-designing and new product development processes (Jean, Sinkovics, & Hiebaum, 2014). Supplier involvement can be a way of facilitating “the speed of development and quality of new products and reduce production costs” (Lau, Tang, and Yam, 2010; Van Echtelt, Wynstra, Van Weele, and Duysters, 2008 in Jean et al., 2014). Supplier involvement is according to Jayaram (2008) very important in New Product Development (NPD) since it:

- Improves project performance and
- Reduces overall development time.

A way to involve the supplier is by integrating the supplier into the processes of the organization. Jayaram (2008) found that the supplier integration practices can be grouped by three factors: communication and information sharing, design participation and infrastructure development of joint programs with key suppliers. The supplier involvement practices should, according to this author, be based on the stability of the market. As the effect of stability was different, i.e. in stable markets, the effect of supplier integration was higher while in unstable markets, the time-to-market was better when the supplier was integrated.

For supplier integration to happen, there are different steps to take. It will start with recognizing a need of the organization, which results in the need for a supplier. Here the supplier selection procedure starts, which was described in chapter 3. In the supplier selection stage, having thought about supplier involvement might be important since taking this into account might lead to different selections. There are several factors that result from supplier involvement, one of them is joint problem solving, which might be useful in involving the supplier.

Joint problem solving

Monczka, Petersen, Handfield, & Ragatz (1998) found that the way in which conflicts are handled has an influence on the success of an alliance. According to these authors using joint problem solving can result in a “win-win” situation for the buyer and the supplier as well as for others involved. Using joint problem solving will lead to “improved quality performance and reduced new product development time” (Monczka et al., 1998, p. 567). Adding to this, Stanley

and Wisner (2001) found that “managers should assess internal and external purchasing/supplier relationships and take action where necessary to increase communication, solve problems and increase general awareness of the relationship between internal and external service and product quality.” They argue that the purchasing department should become the strategic player in the organization and use practices that will create the most value for the customer. It might thus be good to think about how conflicts are handled when involving a supplier. Implementing a joint problem solving strategy might have a positive effect on the relations of the buyer and the supplier. Important in the buyer supplier relationship when involving a supplier is to consider the relative power between the parties, this will be discussed next.

Relative power

Relative power indicates the differences in power between the buyer and the supplier. As power is of influence on any relationship, this is also important in the buyer-supplier relation and thus also in the case of supplier involvement.

According to Caniëls & Gelderman (2007, p. 225) the (1) “difference between buyer’s and supplier’s dependence (net dependence) which corresponds to the relative power of each party and (2) the sum of buyer’s and supplier’s dependence (total interdependence) which indicates the intensity and development phase of the relationship between parties” should be assessed. The relative power is dependent on the type of relationship defined by Kraljic.

As mentioned in the previous chapters, the Kraljic matrix is also important in the buyer-supplier relationships. The different categories defined by Kraljic should lead to different strategies so also the way the relationships are managed between the suppliers should be handled differently. Caniëls and Gelderman (2007) found differences in relative power related to the Kraljic matrix, the results can be seen in table 4.1. From these results it can be concluded that for strategic and bottleneck items, the relationship with the supplier is mostly with dominant suppliers. Only for non-critical items the relationship is balanced in power between both parties. For leverage items, the buyer has a dominant positive position with respect to the supplier. An interesting finding from this study is that buyers expect a relationship where the supplier is dominant when buying strategic items, the suppliers’ marketers should nurture this relation, but not exploit it. When exploiting this relationship, customers might look for substitute suppliers, however when nurtured, the buyers will not look for substitutes and feel good about the relation (Caniëls and Gelderman, 2007).

The different categories in the Kraljic matrix all have different levels of supply market complexity and importance of purchasing. Parker, Zsidisin, & Ragatz (2008) found that the strategic importance of an item is positively correlated with the integration of the supplier. This could thus mean that the strategic items in the Kraljic matrix should be bought from suppliers, which are involved/integrated in the buying firm.

	Relative power		Total interdependence	
	Expected	Observed	Expected	Observed
Strategic	Balanced	Supplier dominance	Highest	Highest
Bottleneck	Supplier dominance	Supplier dominance	Moderate	Moderate
Leverage	Buyer dominance	Buyer dominance	Moderate	Moderate
Non-critical	Balanced	Balanced	Lowest	Lowest

Table 4.1: Comparison of relative power and total interdependence in the Kraljic matrix: theory and practice, from Caniëls & Gelderman (2007, p. 227)

As the integrative capability of suppliers will influence the effectiveness of the involvement relation, elaboration on this topic is necessary and will be done in the next part.

Supplier integrative capability

Supplier integrative capability (SIC) is “a dynamic capability that contains processes to achieve effective and efficient product and information flows between buyers and suppliers (Carr and Pearson, 1999; Swink et al., 2007), as well as the ability to adapt these processes to environmental change” (Vanpoucke, Vereecke, & Wetzels, 2014, p. 447). According to these authors SIC leads to process flexibility and cost efficiency. They also find that “SIC enables buyers to sense changes in the supply environment by sharing information with suppliers, seize opportunities presented by establishing procedures to analyze this information and make long-term changes to existing processes.” Complementary to this, Krause, Youngdahl, & Ramaswamy (2014, p. 401) find that “SIC enable buyers to transform existing processes that not only bring suppliers’ capabilities into alignment with the firm’s operational needs, but also bring about organizational learning that enhances the buying firm’s ability to adapt to a dynamic competitive environment”. So the concept of supplier integrative capability is about aligning the suppliers’ capabilities in line with the buying organization’s capabilities to create a way to share information and be able to analyze and act upon this information. Thus having a high SIC means that changes in the supply market can be sensed earlier and acting upon this can also be done faster. This will reduce the risk when compared to having a lower SIC.

To be able to effectively manage the supplier involvement, portfolios are very useful. In the next part different portfolios are introduced to manage the supplier involvement.

Supplier relationship portfolios

Supplier relations can be managed with the use of portfolios. Good practice is to first, properly balance a portfolio of relationship adapted to product and market conditions and then effectively managing each type of relationships (Bensaou, 1999). Good management of relations should take into account the relationship requirements and relationship capabilities. Only two of the four quadrants in table 4.2 will lead to a successful relationship, i.e. only when there is a ‘match’.

Relationship requirements	High	Underdesigned relationship	Match
	Low	Match	Overdesigned relationship
	Low	High	
		Actual relationship capabilities	

Table 4.2: Relationship requirements and actual relationship capabilities, from Bensaou (1990, p. 43)

So the portfolios that are made should be balanced, adapted to the market and effectively managed. Bensaou (1999) also proposes three key environmental factors to consider in managing the supplier relationship:

- The product exchanged and its technology;
- The competitive conditions in the upstream market and
- The capabilities of the supplier available”.

He also developed a portfolio model based on the investments of the buyer and the supplier, resulting in four different profiles (see table 4.3).

Buyer's specific investments	High	Captive buyer	Strategic partnership
	Low	Market exchange	Captive supplier
		Low	High
		Supplier's specific investments	

Table 4.3: supplier portfolio (Bensaou, 1999, p. 36)

- The *market exchange* profile consists of products that do not require a strong relation between the buyer-supplier. This can be compared to the non-critical items of Kraljic.
- The *captive buyer* profile is closely related to the market exchange, the difference in this is that the technologies used are stable, but the products need some customizations.
- *Captive supplier*, consists of suppliers that deliver highly complex products, the suppliers develop technology to develop these products. The market is changing rapidly so supplier need to invest to keep up or else their buyers will change supplier.
- A *strategic partnership* is in place when there are highly customized components and integrated subsystems. These require great engineering capabilities and technology.

Each profile needs a different approach to manage the relationship. This can also be linked back to the differences in power (see *relative power*). In situations where the buyer has a high relative power, for example in the captive supplier situation, the supplier has to deliver upon the expectations of the buyer to be able to sell his products. It can also be argued that the four C's of supplier relations can be found back in these profiles, however the counterproductive profile does not fit this portfolio model. There is always a need for at least cooperation. The market exchange profile requires the least of relationship management. A collaborative approach here would be sufficient. When a strategic partnership is required however, parties should have a collaborative focus.

Another portfolio model was developed by Wynstra & Pierick (2000) and is more specifically tailored to involving the supplier (see figure 4.4). The aim of their portfolio model is to help managers set priorities when deciding upon involving the supplier in new product development.

Degree of development responsibility held by the supplier	High	Arm's length	Strategic development
	Low	Routine development	Critical development
	Low	High	
	Development risk		

Table 4.4: Supplier involvement portfolio, from Wynstra & Pierick (2000, p. 51)

To find the required relationship, managers should first determine the degree of development responsibility held by the supplier. It should be determined whether the supplier is for example only given purchasing specifications or is the supplier accountable for the whole design and production of the product. To determine the development risk Wynstra & Pierick (2000) developed several questions that can be used, they examine the importance of the development to the buying organization. Table 4.4 shows how the different profiles should be managed. Each profile needs a different approach, i.e. different communication strategy, different intensity of the relation and different connections with the functions in the buying organization.

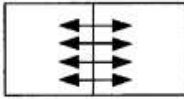
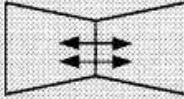
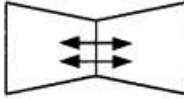
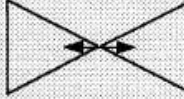
	<i>Strategic Development</i>	<i>Critical Development</i>	<i>Arm's-Length Development</i>	<i>Routine Development</i>
Kind of Collaboration	Close co-operation as 'sparring partners'; Joint development	Focus on obtaining information	Independent development by supplier	Informing each other about changes
Direction of Communication	'Two-way traffic'	'One-way traffic'; at manufacturer's initiative	'One-way traffic'; at supplier's initiative	'Two-way traffic'
Communication Medium	Rich media such as face-to-face group meetings	Lean media such as telephone and fax	Rich media such as face-to-face meetings	Lean media such as fax, mail and e-mail
Amount of Communication	High	Medium	Medium	Low
Functional Disciplines	Diverse	Purchasing/sales (and development)	Development (and purchasing/sales)	Purchasing/sales
Content of Communication	Technical and commercial information	Market (and technical) information	Technical (and status) information	Status information
Communication Structure				

Figure 4.4: Managing the relationships in the portfolio, from Wynstra & Pierick (2000, p. 56)

Techniques

There are different techniques available to effectively integrate/collaborate with the supplier, as mentioned by Park, Shin, Chang, & Park (2010) the most important are: JIT (just-in-time), VMI (vendor managed inventory) and collaborative planning, forecasting and replenishment (CPFR). The techniques a buying firm uses are dependent on the goal it wants to achieve with the relation/involvement with the supplier. "The fundamental objective of the JIT exchange relationship is to eliminate waste of all kinds from the production and delivery systems of the supplier and OEM organization" (Frazier et al., 2015, p. 53). The connection of JIT with

contract management lies in the intensity with which the relation is managed. JIT requires optimal cooperation of the supplier and the buyer to be able to deliver “just-in-time”. Therefore the performances should be evaluated continuously. According to Yao, Evers, & Dresner (2007) vendor-managed inventory (VMI) can improve supply chain performance by decreasing inventory levels and increasing fill rates. In contract management this has implications in the sense that good quality evaluations should be done by the buying firm (see case study 4.2). CPFR is an application to coordinate various activities between the buyer and supplier, these activities include planning, demand forecasting a replenishment (Flidner, 2003).

After having discussed the management of supplier relations and the involvement of suppliers, the next part will be about managing contracts. As managing relationships next to contracts is a part of supplier relationship management insights are given on contract management.

Case Study 4.2: Stocking closets

An example of VMI is the, about 100, closets in the Gasunie building which are filled with office supplies (markers, paperclips, pens etc.). The traditional way of keeping these closets filled was to tell the supplier exactly what you needed every time, the supplier would then fill the closets with these products. This was not the most efficient way, since the supplier is the expert, so something had to change. It was decided that the new way of doing business with the supplier was according to best-value procurement. This meant that the procurement department of Gasunie agreed with the supplier to: “keep the closets filled”. By doing this, instead of giving a list with items they need and to do it in a certain way, but letting the supplier do it their way, the price went down by 40%. The only thing left to do now is checking whether the supplier lives up to the agreement, i.e. are all closets really filled?

CONTRACT MANAGEMENT

The available literature on contract management is limited. It is according to different lecturers (e.g. Ad Weterings, Gasunie, Henk Faber, RUG) a topic that is getting increasingly important. **Contract management** is according to the Nevi report (van den Hoven, 2013) the process of systematically and efficiently managing contracts from creation to execution and analysis, with the aim of maximizing the operational and financial supplier performance and reduction of risks. It is all about ‘getting what you agreed’. So contract management is about managing the contracts within an organization from the point the contract is created until it is evaluated and, in the end, is terminated.

Contract management consists of three steps (van Weele, 2010): order, expedite and evaluate. Where these three steps also include the order and executing phase of the contract (explained by Dr. Faber in our course “Purchasing” in 2015) in for example states that the objectives of contract management should be (1) performance evaluation, (2) escalation problems and fundamental scope changes, (3) indexing pricing and (4) continuous improvement. Continuous improvement, as a result of evaluation is important since it will result in better performance of the cooperating firms. According to Seshadri & Mishra (2004) contracts and relationships are complementary, they should thus always be managed in terms of relationship management.

They also state that contracts provide an “evolving governance structure for relationships” (Seshadri & Mishra, 2004). By providing the following framework (figure 4.5), the dynamics of markets, contracts and relationships are represented. This framework is useful when examining the type of relation that is applicable to the contract with a supplier. When for example the outcomes are unverifiable and actions are unobservable, the contract manager should use relationship marketing to manage the contract. **Relationship marketing** is defined by Morgan & Hunt (1994, p. 34) as referring to “all marketing activities directed toward establishing, developing, and maintaining successful relational exchanges”. In these cases the relationship should be very good since mutual trust is necessary to be able to do business.

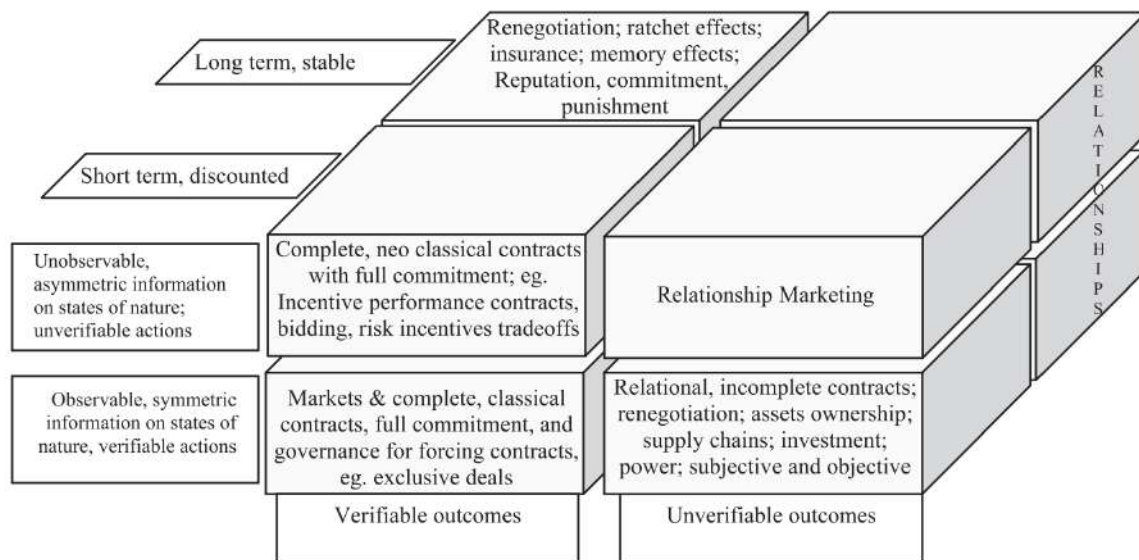


Figure 4.5: Dynamics of markets, contracts and relationships (Seshadri & Mishra, 2004).

Adding to this, Lumineau & Henderson (2012, p. 382) state “increasing contractual control governance for a buyer–supplier dyad with competitive relational experience will increase cooperative negotiation strategy”. It will however affect the cooperative relational experience in a negative way.

Luo (2002) stresses the importance of managing contracts in relations by his finding that the completeness and cooperation have an interacting effect, i.e. when contracts are more complete, they provide opportunity for better performance. He also finds that the contribution of the cooperation between buyer and supplier to the performance is a linear relationship. Cooperation thus leads to better performance. Concluding from this, contract management can be seen as very closely related to relationship management.

Poppo & Zheng Zhou (2013) found that contractual design should go further than just establishing a safeguard. Contracts should according to them be complemented with other practices, such as monitoring and socializing. They find two types of fairness; the first is procedural fairness, which refers to the process of the allocation decision. The second type is distributive fairness, which entails the way outcomes that are related to an allocation decision are evaluated. The procedural fairness (how allocation decisions are made) explains a part of the effect of contractual complexity on the exchange outcome. The effect of recurrence of contracts on the outcomes of the exchange relationship is partially explained by distributive fairness (Poppo & Zheng Zhou, 2013). If the relations perceived as more fair by the involved parties, the exchange outcome will benefit from this.

Case Study 4.3: Producing lean

Another well-known concept is lean. This term is used to indicate “a system that uses less of all inputs to create outputs similar to the traditional mass production system, while offering increased choices for the end consumer”(Hines & Brief, 1996, p.4). According to these same authors, there are within a lean production system, three overriding imperatives:

1. The management of processes and the integrated logistics flow
2. The management of relationships with employees, teams, and suppliers
3. The management of the change from traditional mass production

This thus implicates that the supplier should be involved in the buying firm to effectively perform the lean operation. The purchasing department can be of importance in enhancing quality, lowering costs and delivering existing products.

From the above findings it can thus be concluded that contracts and relationships function in a complementary way by providing a structure for relationships. Contracts might call for increased control (evaluation and monitoring), however control might be good as it leads to a better cooperative negotiation strategy, it has a negative effect on the relational experience of the buyer-supplier relationship. Adding to this, complete contracts provide better cooperation, which in turn leads to better performance. To achieve better outcomes from contracts, they should go further than just having the function of building securities in the relationship; they should also provide a way to manage the relationship. Fairness in this relationship is an important factor as higher perceived fairness leads to better exchange outcomes (i.e. relationship performance).

Tools to effectively manage contracts are 6sigma, lean (case study 4.3), PDCA and DMAIC. These are all well-known tools, there will be no further elaboration on these tools here as it is not within the scope of the book, see table 4.5, for references to the tools.

Tool	Articles (e.g.)
Six sigma	Jones, Parast, & Adams, 2010
Lean	Cox, 1996, Jasti & Kodali (2014), Hines & Brief (1996)
PDCA	Park et al., 2010
DMAIC	De Mast & Lokkerbol (2012)

Table 4.5: Reference articles to techniques

Also proactive learning should be applied by the organization to learn from the past. Emden, Yaprak, & Cavusgil (2005) argue that managers should pursue “proactive and systematic strategies to capture and institutionalize alliance experiences”. To do so, they state that managers should conduct reviews periodically to find unsuccessful and successful procedures and gather experiences from directly involved workplace personnel. The results from this should lead to modifications in the strategies towards the partner and transferring the knowledge from this throughout the organization. Transferring the knowledge through the organization might refer to the concept of **organizational learning** which is “the acquisition of new knowledge by actors who are able and willing to apply that knowledge in making decisions or influencing others in the organization” (Miller, 1996, p. 486).

Contract management thus entails the management of contracts and with that, the relations. As was explained, careful monitoring of the supplier is a necessary condition for effective contract management. Therefore the suppliers should be evaluated and managed as such. In the next part supplier evaluation and development is elaborated to get a better understanding of how this is done.

Supplier Evaluation and Relationship Models

Evaluation & Monitoring

Supplier evaluation is located at the end of the purchasing process but is however essential for buying firms in controlling and monitoring their suppliers. Evaluation is used to see if a supplier performs according to the agreements or “preliminary assessment of potential new suppliers” (Hahn et al., 1990, p. 5) The last few years, the importance of supplier evaluation increased due to globalization, changing in the preference of buyers and the complexity of buying decisions (Pressey et al., 2009). Johnsen et al. (2014, p. 99) argues that buying firms should use key performance indicators (KPI’s) because suppliers will not perform according to the agreement, if they are not measured. Those KPIs should reflect the purchasing strategy of a firm. Research has shown that if buyers do not measure supplier performance, decision making becomes inconsistent and performance decreases to mediocre levels (Dumond, 1994 in Johnsen et al., 2014) However, introducing KPI’s has a downside because it is assumed that suppliers will focus on the set of KPI’s and neglect aspects that are not included or could not be captured by KPI’s. One way to measure KPI’s and supplier development is through a balanced score card, earlier mentioned in chapter 2. KPI’s should be used to start a dialogue with supplier, jointly developed and used collaboratively (Hughes, 2005 in Johnsen et al. 2014) instead of forcing them on the supplier. The clarity that it creates at the supplier could be used to address problems and improve supplier performance. Supplier evaluation is the basis of relationship development and important in developing of buyer-supplier relationship. However, countries differ in the way they evaluate suppliers. For example, Japanese firms do not assess their suppliers with a formal rating system like American firms do. They evaluate suppliers on a regular basis and the degree of assistance from the buying firm is determined by the evaluation (Hahn et al., 1990). Below, supplier development and the other drivers & barriers of buyer-supplier relationships are discussed.

Models of Buyer-Supplier Relationships

Buyer-supplier relationships are perceived as “static” in most relationship models, in reality these relationships emerge, evolve, grow and dissolve over time (Ring & Van de Ven, 1994). “Improvements in performance will happen within the unique exchange relationships developed between the buyer and supplier firms” (Lee et al., 2007, p 231 in Wagner 2011) this quote highlights the previous statement that relationships have to be seen as dynamic and should be developed. Organizations can develop their supplier relationships on 2 levels: a one-on-one basis between the buyer and one or multiple suppliers or on a global level between a large customer firm and a network of its direct suppliers (Krause & Ellram, 1997). Supplier development provides the basis of dynamic buyer-supplier relationship models. Krause (1997, p. 12) defines **supplier development** as “any effort of a buying firm to increase the performance and capabilities of the supplier”, which in turn will improve the buyer performance. There is a large set of supplier development activities that can be used like training programs for employees of the supplier, investments in the supplier and supplier evaluation. Krause and Ellram (1997) state that supplier development can be important and analyzed from 3 perspectives: from purchasing, corporate and national point of view. This chapter will focus on the purchasing point of view. Supplier development can create a secure and effective source of supply, help reach strategic objectives and help the domestic country (Krause & Ellram, 2007). The latter needs a bit more explanation to fully understand the impact of supplier development on the domestic country. The industrial bases of developed markets are increasingly moving abroad in the last few years (Krause and Ellram, 2007). This could have serious consequences for those countries. Supplier development could block this emerging trend because it increases the capabilities and performance of domestic suppliers, which increases their competitiveness. Life cycles have been used to show the evolution of certain phenomena. The product life cycle is the best-known example of a life cycle. The product life cycle (see appendix 1) shows the unit sales curve of a product from the moment it enters the market until it is taken off the market. It portrays “the evolution of product attributes and market characteristics through time” (Rink and Swan, 1979). The product life cycle model assumes that there are 4 stages: introduction, growth, maturity and decline. However, there are buyer-supplier relationship life cycles as well. Wagner (2011) did an extensive research on dynamic buyer-supplier relationship life cycle models. The paper highlighted 3 dynamic models that were leading to better performance (figure 4.6). All models show how performance is related to relationship length. However, different scholars (Dwyer et al., 1987; Frazier et al., 1988; Jap and Ganesan, 2000; Medlin, 2004; Wilson, 1995 in Wagner, 2011) have categorized the life cycle phases in different ways but they do agree that the phases are characterized by their strength of growth and direction. This book defines three phases: initiation, maturity and decline. The first model shows a simple linear relationship between supplier development and relationship length to performance. Then, a model that links supplier development with 2 kinds of knowledge exchange to performance with relationship length as a moderator is presented. Kotabe et al. (2003) divide knowledge exchange into technical exchanges and technology transfer. Technical exchanges encompass “small-scale exchanges of technical information” (Kotabe et al., 2003, p. 297). Buyer and supplier share technical information on a regular basis, which improves products and processes and could be used to solve problems. Technology transfer is the shipment of complete technical capabilities to the partner to solve a problem or exploit opportunities (Kotabe et al., 2003). Transferring knowledge will not happen immediately at the start of the relationship but will develop over time, especially technology transfer. That is why the paper uses relationship length as a moderator. Finally, Wagner (2011) constructed his own model in which he squared the moderator, relationship length. The paper argues that a squared moderator “is a much better reflection of the dynamic nature of buyer-supplier relationships of the relationships lifecycle”

(Wagner, 2011, p. 279). The model of Wagner can be divided in the previous mentioned phases. The impact on performance of supplier development is low in the initiation and decline phase. This is due to the fact that the effect of relationship properties (e.g. adaption, cooperation, commitment, information exchange) will decrease over time.

Source	Model	Proposed relationship
Proposed by Krause, Handfield, and Tyler (2007)		
Proposed by Kotabe, Martin, and Domoto (2003)		
Proposed in this research		

RL: Relationship length; P: Performance; SD: Supplier development

Figure 4.6: Dynamic buyer-supplier relationship models (Wagner, 2011, p. 279)

However, other researchers see supplier development as a continuous process. Ring and van de Ven (1994) argue that supplier relationships are “socially contrived mechanisms for collective action, which are continually shaped and restructured by actions and symbolic interpretations of the parties involved.” They developed a framework (figure 4.7) that can also be divided in an initiation, maturity and decline phase. The framework consists out of 3 stages which are continuously assessed on efficiency and equity. The first stage is negotiation, then commitment and finally the execution stage, all stages overlap each other. However, the duration of the stages differs per supplier and transaction due to differences in uncertainty, trust among the parties and the role relationship of the different entities. During the negotiation stage, the parties involved develop joint trust, expectations and assess the risk of the relationship. This is accomplished by an iterative process of formal bargaining and informal sense making that leads independent buyers and suppliers into a negotiation and develops a deeper understanding of each other. The commitment stage leads to an agreement, which encompasses the terms, the structure of the relationship becomes clear and a contract is established, informal or formal. The commitments and proposed actions are executed in the final stage, the execution stage. The final stage is highlighted by interaction, both role and personal, Ring and van de Ven (1994, p. 98) argue that “formally designated role behavior by the parties reduces uncertainty when the execute commitments, and it make interactions among parties predictable.” After a while, focus can shift from role interaction to personal interaction were parties can rely on interpersonal relationships. Conflicts, misunderstanding and time but also efficient past experiences can lead to renegotiations of continuing, quitting or expanding their relationship. Hence, Ring and van de Ven agree with Wagner that relationships length do not always improve performance and can even reduce performance over time. However, Ring and van de Ven (1994) argue that relationships can be improved at all time. In the case of continuing and expanding their relationships, the cycle starts all over again. The relationship could end in two different scenarios:

- The deal is completed and both parties have delivered on their promises
- One or both parties failed to live up to the contract.

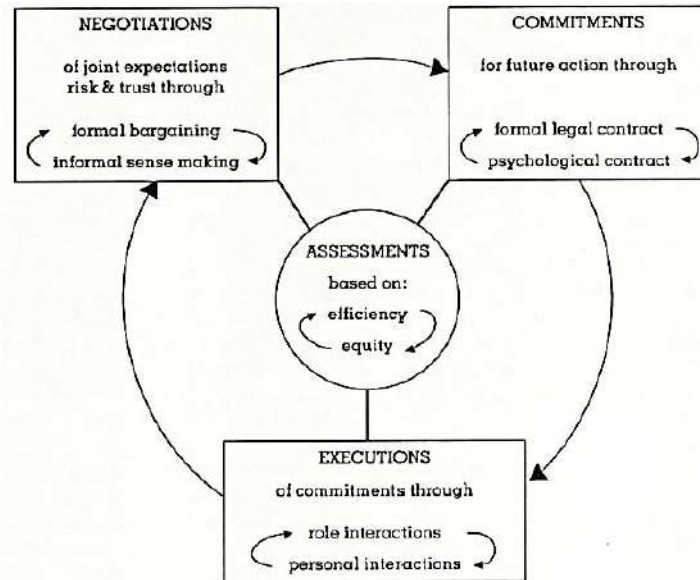


Figure 4.7: Continuous buyer-supplier development model (Ring and van de Ven, 1994, p. 97)

DRIVERS AND BARRIERS

There has been much research done on supplier relationship development, which revealed several drivers and barriers. One of those researchers are Humphreys et al. (2004), their research complemented the findings of Krause and Ellram (1997) about the importance of supplier development. Figure 5 shows a framework, from a buyer his perspective, which links supplier development practices to buyer-supplier performance improvement. Transaction-specific supplier development represents the direct involvement of the buying company in developing the supplier, the core practice of supply development (Humphreys et al., 2007). Infrastructure factors are requirements for the effective execution of transaction-specific supplier development activities and comprise the environment. The framework mentions 11 drivers and barriers for relationship improvement, which are mentioned in figure 4.8.

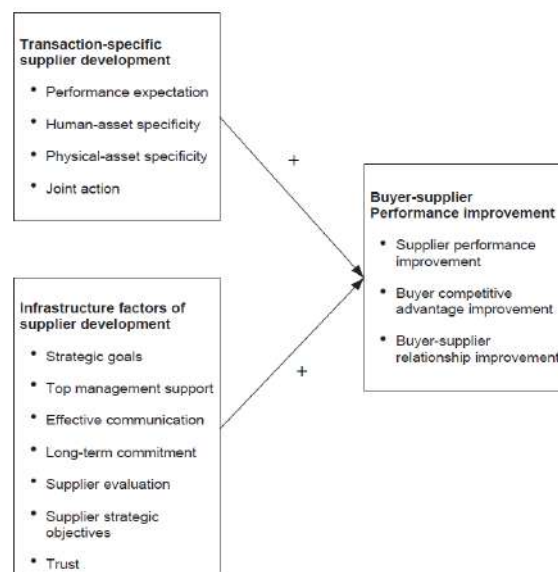


Figure 4.8: Supplier development framework (Humphreys et al., 2004, p. 133)

This book combines different researches (Ellram, 1995, Krause & Ellram, 1997; Humphreys et al., 2004; Johnsen et al., 2014) and mentions the most important drivers and barriers of supplier relationships. The only factor that was not mentioned by diverse scholars is culture, however this book adds culture because it is an essential factor in globalization. The following drivers and barriers will be discussed in the remainder of this chapter: Trust, Culture, Communication, Top Management Involvement, Long-term Commitment and Relation-Specific Investments, Shared Goals & Mutual Benefits.

Trust

In the competitive environment of business, organizations have to be creative to create competitive advantages. As been explained in previous sections, supplier relations play an important role in this creation of competitive advantages. An important factor in the positive interactions between supplier and buyer in purchasing is trust. Gao, Sirgy and Bird (2005) explain the essence of trust in business: “mutual trusting behaviors and bilateral perceptions of trustworthiness must exist for a relationship to become stable and long lasting (Anderson & Weitz, 1992; Smith and Barclay, 1997, p.398)”. In trusting relationships every party in the supply network has mutual confidence in the other members’ capabilities and action (Handfield & Nichols,1999). Mutual trust between buyer and supplier is necessary for a good relation. Literature suggests that, regardless of the level of analysis, trusting parties must be vulnerable to some extent for trust to become operational (Donney, Cannon, 1997). With the globalization of strategic purchasing trust becomes of greater importance. Distances between supplier and buyer are becoming bigger, face to face meetings are harder, so trust in the right settlement of actions is needed.

The trust in a supplier is of great importance for buyers purchasing decisions. Research has shown that trust in the supplier has a positive influence on the buyer’s purchasing decision-making uncertainty (Gao et al., 2005). Same counts for the trust of the suppliers in their buyers. What Sako and Helper (1998) also mentioned is that suppliers’ trust can positively be influenced, by getting technical assistance of their customers. Gao et al. (2005) designed a decision making influence model for purchasers (figure 4.9), where 3 factors influence the trust of the buyer in the supplier; perceived commitment, perceived supplier trust and perceived supplier dependence. The three are relational factors, which are build up out of their previous relationship.

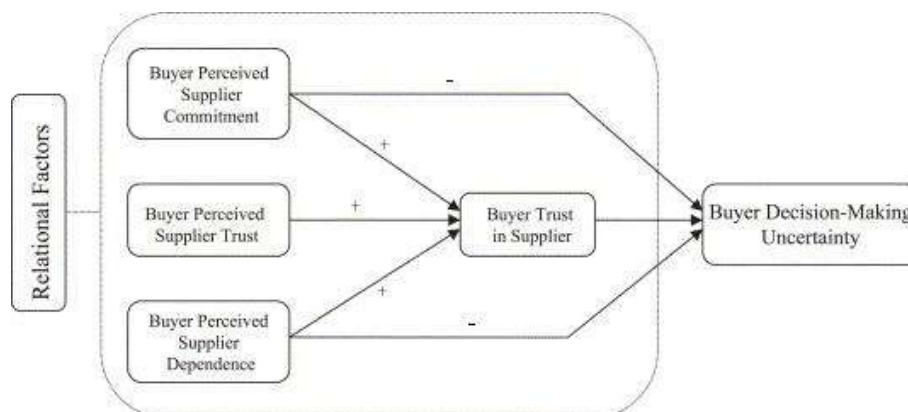


Figure 4.9 Decision-making influence model (Gao et al., 2005, p. 398)

The decision model is designed for the decision-making uncertainty of the buyer, but the three factors, which influence the trust, also work the other way around (Supplier their trust in the buyer) (Table 4.6).

Relational factor	What?
Perceived commitment	Commitment in relationships means that exchange partners believe in their relations with the other parties involved, and that the other party believes it is so important that maximum effort is guaranteed to maintain the relation. (Morgan & Hunt, 1994).
Perceived trust	The amount freedom and trust felt given by the other side. For trust in relationships to work, it has to be mutual
Perceived dependence	Dependence of a supplier on a buyer refers to a suppliers need to maintain the channel relationship to achieve desired goals (Frazier 1983; Ganesan, 1994).

Table 4.6 Relational factors (Gao et al., 2005)

How far the considerations in trust matters depends on the amount of easily accessible alternatives there are for the buyer to purchase from other suppliers, suppliers should depend less on the trustworthiness of the buyer if there are many other alternatives for the buyer (Sako & Helper, 1998). The same counts for how much the buyer should depend his purchasing decisions on the trustworthiness of the suppliers, if there are not many other alternatives, they should depend less on the trustworthiness of their suppliers in strategic purchasing decisions since there are no other alternatives. Apart from this form of trust, there is also global trust, which is especially important in the global environment.

Global trust

With the globalization of strategic purchasing, the perspective of trust has to be analyzed from different parts of the world. There many different cultures, and all of these cultures have different perspective on trust. A good example is the differences between the relationships in automotive industry of the USA and Japan (see case study 4.4).

Case Study 4.4: Trust relationship differences between the automotive industry in Japan and the USA.

Sako and Helper (1998) investigated the difference in trust relationships in the automotive industry between Japan and the US in 1998. They have found three big differences in the aspect of trust; (i) the concept of trust is much more complex in Japan, in comparison with the US.(ii) the level of trust of suppliers is much higher in Japan than in the US.(iii) the determinants of trust are different in the US as they are in Japan.

i) The conceptualization of trust is far more complex in Japan. Japan distinguishes a lot more types of trust. These types of trust are not only opposites of each other, but can also be overlapping.

ii)The levels of trust are much higher in Japan because of the involvement of the suppliers in the whole business process. And also the Japanese customers are being perceived as trustworthy customers. While the customers in the US are often being perceived as distrustful customers. An example for this is General Motors (GM), they were not able to commit them as credible customers.

iii) the determinants of trust differ a lot. In Japan technical assistance, customer help and cost sharing also are associated with goodwill trust. While these determinants do not play a role in the perception of trust in the US. Long contracts are an indication of low trust in Japan, but did not play a role in the US.

When looking at the performances of the automotive industry in the US and Japan, one will see that the performances of the Japanese automotive industry were way better than the US. So what could be said about trust in relationship?

(Sako & Helper, 1998)

After having discussed trust and global trust, the focus will now be on other drivers and barriers, the next part will be about the cultural differences, which are important when, purchasing from other countries.

Culture

In maintaining supplier-buyer relationships around the globe, organizations have to be aware of cultural differences between businesses in the global economy. An important remark made by Ribbing & Grimm (2014, p.122) is: “The presence of cultural differences facilitates misunderstandings and errors in judgment during interactions between the participants”. Negotiations are much harder when there is complexity in the relationships between organizations of different countries, which have different culture. Culture has an important influence on trust between organizations, previous research has shown that organizations with cultural similarities have a positive influence on trust between the organizations, but this is not the case with cultural differences (Pagell, Katz & Sheu, 2005). Culture is not necessarily the same between nations who are positioned next to each other. France and the United Kingdom, which are located close to each other, have a different culture. Similarly, the business practices in Hong Kong are different if you compare them to China and Vietnam, which are in the same geographical region (Pagell, Katz & Sheu, 2005).

Hofstede (2010) introduced six dimensions, which define cultural differences and similarities (Table 4.7). With the globalization of strategic purchasing these dimensions can be used to maintain fluently working relationships between suppliers and buyers.

1. Power distance index (PDI)	The PDI defines the problem of human inequality.
2. Individualism vs. Collectivism:	This defines how individuals in the organization are integrated into groups.
3. Uncertainty Avoidance (UA):	This defines how employees cope with uncertainties.
4. Masculinity vs. Femininity:	Focus is more on competition, achievements and materialism vs. focus on cooperation and the quality of life.
5. Long-term orientation vs. Short-term orientations:	Focus on the future vs. focus on short-term achievement.
6. Indulgence vs. Restraints:	Defines how the amount of freedom the people have in their culture for doing their jobs.

Table 4.7 Hofstede National Cultural dimensions (Hofstede, 2010)

Differences in power distance and individualism/collectivism in purchasing could cause conflicts in the interaction process between the buyer and supplier (Cheung et al., 2010). Collectivism can for example have a positive effect on relationships. Relationships between cultures with collective organizations tend to be stronger, more intimate and loyal. This is less between organizations, which tend to be more individualistic (Cheung et al., 2010). Relationships between individualistic and collective organizations ask for more active managing. UA plays a large role in the relationships between global organizations. Organizations that score high on UA, buyers makes use of a formal supplier selection criteria, and often apply a centralized and formal contracting procedure (Pemer et al., 2014). A good example for Masculinity vs. Femininity is the difference between the focus of American organizations and Japanese organizations in the 90's. American organizations were more focused on achievements, while Japanese were more focused on the quality of life (Sako & Helper, 1998). Pemer et al. (2014) proposed out of previous researches that organizations that score high on masculinity buyers evaluate their relationships with the suppliers more risky and problematic than in more feminine organizations.

As mentioned earlier in the book the aim of strategic purchasing is to minimize the amount of suppliers, and focus on long-term supplier-buyer relationships. But there are still nations that have a culture, which is merely short-term oriented.

Culture thus is important to a firm when doing business with companies in other countries; communication is a vital part in this relation as well. Communication can be essential when having to do business with other organizations, Communication will be discussed next.

Communication

Many scholars found that communication is vital for supplier development (Lascelles and Dale, 1989; Hahn et al., 1990; Newman and Rhee, 1990; Galt and Dale, 1991 in Krause and Ellram, 1997). **Communication** can be defined as “the formal as well as informal sharing of meaningful and timely information between firms” (Anderson and Narus, 1990, p. 44 in Morgan and Hunt, 1994). Communication is not only directly important for supplier development but also indirectly, via trust. Communication enhances trust by assisting in resolving conflicts and the alignment of expectations and perceptions. Also, high levels of trust improve communication between two parties. The increasing level of globalization asks more speed and agility in information sharing and information needs to pass more gates, which

increase the possibility of miscommunication (Hughes and Weiss, 2007). Communication could be a barrier as well. Hughes and Weiss (2007) argue that a common phenomenon among parties that limits information sharing is the fear of being extorted. Humphreys et al. (2004) found that communication has a significant influence on supplier performance.

As communication is an important concept to take into account in a relation with a supplier, internal there should also be a good coordination. Therefore top management should be involved, as is discussed next.

Top management involvement

Also top management involvement is important for supplier development. Humphreys et al. (2004) stated that top management is the key enabler for initiating supplier development activities based on the competitive strategy of an organization. Decision making authority lays at the top management teams of firms, if there is no support for developing relationships among the firm and its suppliers. Long-term collaborative relationships will not develop and no sustainable competitive advantages will arise from the buyer and supplier relationship.

Having the top management involved is an essential condition for long-term commitment to a supplier. So this will be discussed in more depth.

Long-term commitment & Relation-specific Investments

Commitment can be an important driver or barrier for supplier development. A lack of commitment and frequently changing suppliers will not create a long-term buyer-supplier relationship. Long-term commitment can be demonstrated in many different ways. One of those is a long-term contract, which is mentioned previously in this chapter. Another way to show commitment is via firm specific investments. Humphreys et al. (2004) state that relation-specific investments show a direct involvement of the buying company in the development of the supplier. "Relation-specific investments could make suppliers more willing to make customized items for customers, allow both parties to communicate more efficiently and hence result in shortened product development cycles and reduced procurement costs" (Dyer, 1996 in Humphreys et al., 2004, p.133). Associated with long-term commitment, is also risk for the supplier and buyer because it requires resources and time, that will not pay-off immediately.

For a relation with long-term commitment, companies should have shared strategic goals, these will result in mutual benefits.

Shared Strategic Goals & Mutual benefits

When a buying firm selects a supplier, the goal is that both parties have the same expectations of the cooperation/collaboration and the future growth and performance. Humphreys et al. (2004) argue that a close strategic match should be constructed between the buyer and supplier that grow capabilities and performance of both parties. Suppliers with improve capabilities and performance can serve the buying firm in many ways like cost advantages and improved quality. Supplier development is a process where mutual recognition is required. Supplier recognition can serve in 2 ways. First of all, it could be used as a motivational tool where suppliers improve their status in the market and therefore create new opportunities. Finally, "supplier recognition may mark the culmination of the supplier development effort with a particular supplier" (Krause and Ellram, 1997, p. 25)

CONCLUSION

As an important part of the purchasing function is about managing relationships with suppliers, also in a global context, different concepts related to supplier relationship management were introduced and discussed. Along with these concepts, different models and theories were discussed. It was found that managing supplier relations in purchasing in a global strategy is very important for the success of an organization. Companies should manage the relationships through classifications of their suppliers. So every supplier should be managed differently. It was also proposed that managing supplier relations should go beyond the first tier supplier, also second, third, etc. tier suppliers should be managed. In managing supplier relationships, supplier involvement is a different part since it requires very close cooperation with the supplier. When managing supplier relationships, the contracts with these suppliers should be managed; an overview of contract management was given. It was also found that some parts of the contract could foster the relationship between buyer and supplier. Further research in the upcoming area of contract management is necessary. As a big part of contract management should be about evaluating and monitoring the supplier, it was found here that the development of a supplier relation follows a life cycle type of model, but can also be represented as a continuous process. In the end, different driver and barriers of supplier development were discussed, in globalized marketplace concepts, as trust, culture and communication are especially important.

FUTURE SECTION

The supplier relations in the area of purchasing are changing. In this regard, the focus shifts from short-term to long-term contracts. More firms start to recognize the importance of good relationships with the supplier and the benefits of involving the supplier into their processes. Also the upcoming area of contract management will be important in the future, a trend can be seen where more companies start to focus on managing the contracts and with that the supplier relations. As there is little literature available on contract management, future studies should do research on this as it is an important topic. The evaluation based on costs seems to be something of the past, as more companies start to focus on the quality of their products. The focus on quality might, in the long-run, lower the costs. This is getting accepted by managers, therefore the future in this area will be more quality based. When it comes to supplier development, a lot of knowledge is already available, however there is more to gain from this knowledge. As firms start to acknowledge the importance of keeping good relations with their supplier and make use of development of supplier, the future will be more focused on the interchanging relations between buyer and supplier.

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Chapter 5

PURCHASING PROFESSIONALISM

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Abstract:

The main goal of this chapter is to propose a clear description of the purchasing profession and the purchasing department, by identifying the different jobs and tasks recognized both by literature and in the real world of business. It also presents the range of skills, both the managerial and specific purchasing skills, acknowledged as essential to achieve a level of strategic purchasing. This chapter further discusses how a purchasing department can develop these skills and achieve strategic competence and in what way the purchasing performance can be measured. Taking into account the effects of globalization this chapter introduces the importance of cultural differences that should be considered while procuring at a global level, and the skills that need to be developed to enable a company to be successful while finding and relate to suppliers from different countries. Finally a description of how the purchasing status varies and influences the effectiveness of the purchasing department is given.

Key Words:

- **Purchasing Profession**
- **Purchasing Department**
- **Skills**
- **Purchasing Performance Measurement System**
- **Purchasing Status**
- **Human Resources**

INTRODUCTION

In this book there are examined the most important aspects of strategic purchasing. Supplier relations, internal alignment and strategy have already been explained. The important condition for a contribution to financial performance for these aspects however, is the professionalism of the purchasing department (Hartmann, Kerkfeld, & Henke, 2012). The word competence can also be used with reference to the level of professionalism (Hartmann et al., 2012). According to Mulder et al. (2005) competencies are clusters of knowledge, attitudes, skills and values. Skills are part of the competencies. Skills are the basis and a prerequisite for good supplier-relationship management, dealing with the internal customer and other facets of purchasing. The professionalism of the purchasing department has a significant influence on organizational performance (Feisel, Hartmann, & Giunipero, 2011) Therefore the importance of a thorough investigation in skills cannot be underestimated.

This chapter will focus on (1) the levels of strategic competence the purchasing department can reach and (2) the specific skills that the purchasing profession should possess to be strategic competent.

Hereafter there is continued with a description of the purchasing profession. After that, the skills that belong to this profession are mentioned, and the benefits from this skills for the company. From the Kraljic' matrix, there will be determined which skills are necessary for which purchasing context. Furthermore it is important for companies to know how they can evaluate and develop their purchasing competence and skills. Globalization affects the set of skills a purchasing professional needs. How can companies deal with globalization with respect to purchasing? These issues will be examined with recent literature and some case studies.

Purchasing Profession

This chapter starts with a clear explanation of the purchasing profession, the purchasing department and the job positions that compose it. Therefore it will be clear in the rest of the chapter in which perspective the skills and jobs have to be placed. Furthermore some important trends that influence the purchasing profession will be discussed.

Different organizations have different views on purchasing (Carter, Carter, Monczka, & Slaughter, 2000). And most large firms have a purchasing department, therefore it can be considered a wide profession (Mulder et al. 2005). Mulder et al. (2005) studied the role studies, which underline the importance of the analyses of work processes in terms of outputs, competencies, levels of mastery and trends that have an influence on the development of the profession. Looking at the purchasing profession the outputs which are generated by the purchasing department have to be taken into account, so as the competencies they need to possess, the different levels of mastery and the trends that influence the development of the purchasing profession.

To start, it is essential to look at the purchasing department, how it is organized and what tasks constitute the different jobs. Mulder et al. (2005) categorized the jobs in four categories: Purchasing Manager (PM), Senior Buyer (SB), Buyer (B) and Assistant Buyer (AB). The tasks were also categorized in four categories: Management, Information and Communication, Initial purchasing and practical purchasing.

In Table 5.1 it is possible to analyze the importance of the different tasks in the different job categories. For the purchasing manager and the senior buyer the most important tasks are

management and information and communication, the senior purchaser is also important in the initial purchasing tasks. The last category, practical purchasing, is more appropriate for buyers and assistant buyers job categories. For globalization are both the purchasing manager and the senior buyer very important (both ++). Further are for the improvement of the purchasing organization both the purchasing manager and the senior buyer very important (both ++) and the buyer and assistant buyer important (both +), so everybody has to be involved in improving the purchasing organization.

Tasks	PM	SB	B	AB
Management				
Developing purchasing policy	++	+	-	-
Managing the purchasing organisation	++	+	-	-
Improving the purchasing organisation	++	++	+	+
Information and Communication				
Communication with internal sectors	++	+	+	+
Communication with external sectors	+	++	+	-
Information technology	++	+	-	+
Globalisation	++	++	-	--
Initial Purchasing				
Specifying the purchasing need	-	++	-	--
Selecting the suppliers	-	++	+	--
Contracting the suppliers	-	++	+	-
Practical Purchasing				
Ordering goods and services	--	-	+	++
Monitoring the purchasing process	--	-	++	++
After care, evaluation and administrative conclusion of the purchasing process	--	-	+	++
PM = Purchasing Manager, SB = Senior Buyer, B = Buyer, AB = Assistant Buyer				
++ = very important, + = important, - = unimportant, -- = very unimportant				

Table 5.1: Task description and application to job categories (Mulder et al. 2005)

There are differences in the role of the purchasing department, but there are also some general trends identified by different authors, which influence both the purchasing profession and the different skills needed. The skills needed, will be discussed in the next paragraph. The fact that purchasing directors, are moving into the board as CPEs, chief purchasing executives, emphasizes the upcoming strategic importance of the purchasing profession (Mulder et al. 2005). According to Carter et al. (2000) the purchasing professionals even will have a key role to play in the education of other functions within the organization about the strategic importance of purchasing. In very large companies, the purchasing department can consist of a central corporate purchasing unit and multiple decentralized purchasing departments (Mulder et al. 2005). In some industries, for example the chemical industry, purchasing directors can have budgets of billions of euros or dollars, in these companies the purchasing department plays a vital role in the financial performance (Mulder et al. 2005). Not only the trend of purchasing becoming strategically more important has an influence on the purchasing profession, but also

the trend of globalization (Mulder et al. 2005). Not only Mulder et al. (2005) acknowledge this, Carter et al. (2000) also developed a list with trends, which will have an impact on the purchasing profession. Globalization plays an important role in this list as well. And according to Zheng et al. (2007) will the globalization trend, among others, have an influence on the purchasing strategy, the structure and the skills that are required.

Case Study 5.1: UMCG's purchasing department

In figure 5.1 it is possible to see the organigram of the purchasing department of UMCG this was made available by Hans Bax, head of procurement UMCG, in a guest lecture at RUG University.

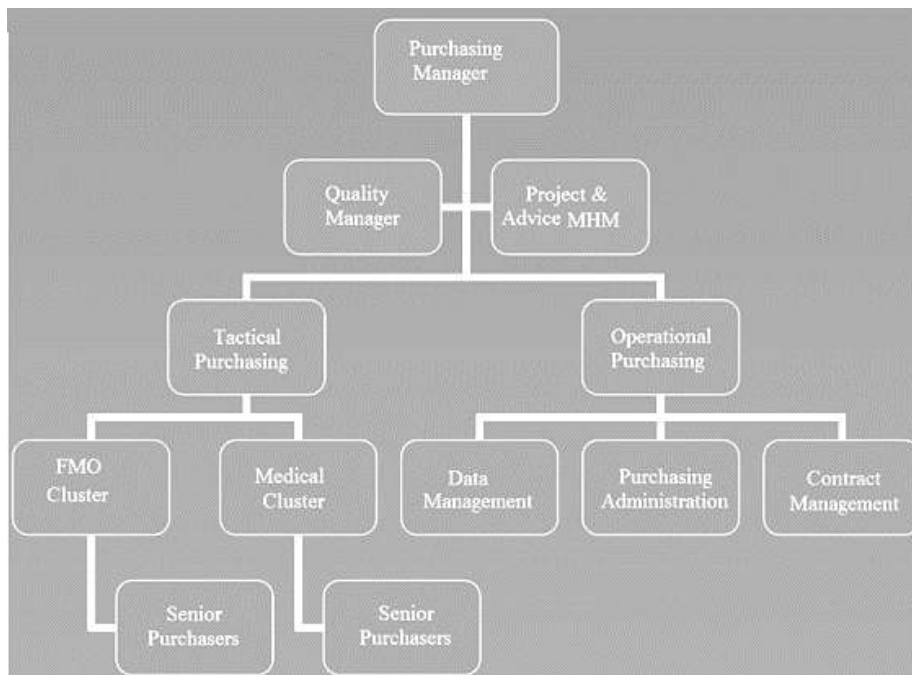


Figure 5.1: Organogram of UMCG's Purchasing Department adapted from guest lecture (Bax, UMCG)

In the figure it is possible to identify in the organigram two (Purchasing Manager and Senior Purchaser) of the four categories identified by Mulder et al. (2005) while investigating the different jobs and tasks in a purchasing department, this is the real world application of the findings of Table 5.1.

SKILLS

As mentioned in the introduction, are skills a part of the competencies. “Competencies are seen as clusters of knowledge, attitudes, skills and values needed to perform certain tasks, solve problems, and to generally allow one to function adequately and effectively in a certain discipline, trade, organization, function or role” (Mulder et al. 2005, p.196). Mulder et al. (2005) developed a list of competencies a purchasing professional should possess. A clear distinction has to be made between competencies and skills, as explained in the above-mentioned definition, are skills a part of competencies. Although competencies are more than only skills, they give a good impression of what purchasing professionals should be capable of. Therefore, the competencies are discussed in this paragraph as well.

Competence	Explanation
Purchasing	The purchaser is able to obtain the required goods and services of the selected supplier on the basis of specifications of the internal customer
Integral thinking	The purchaser is able to consider all the aspects of and consequences for the organization when actions are taken and decision have to be made
Analytical abilities	The purchaser has the capacity to make a good analysis of the relations between, cause and results of situations, decisions and actions
Generalizing	The purchaser is able to draw a conclusion at a general level from some specific actions or decisions
Information management	The purchaser is able to record new and useful information and is able to make it accessible for other colleagues
Financial management	The purchaser is able to make considered decisions in the financial margin of an assignment, project or department
Customer orientation	The purchaser is able to determine the needs of the internal customer and is able to cater to or to anticipate on these needs
Negotiating	The purchaser is able to effectively communicate arguments, pointing out common viewpoints and interests in an manner which causes all parties to accept and agree
Advising	The purchaser is able to effectively communicate relevant advice on purchasing
Networking	The purchaser is able to develop and maintain effective relationships in a formal as well as in an informal manner, with the aim of realizing a mutual added value for the different parties
Legal-solving abilities	The purchaser has at his disposal legal insights, so he can use this knowledge an these skills in problematic situations

Table 5.2: Description of Mulder's Competences (Mulder et al. 2005)

After the competencies, the skills, in more detail, a purchasing professional should possess will be discussed. The competences are summarized in Table 5.2 As can be seen through the analysis of Table 5.2 a purchaser should possess a lot of general competencies besides the actual purchasing competencies, for example the integral thinking, generalizing, information management and financial management. All these competencies are about the purchasing professional taking into considerations other functions of the organization or the whole organization.

Other authors present a similar model. The model of Tassabehji & Moorhouse (2008) can be seen in Figure 5.2 These authors also separate managerial and procurement skills, being that only the left part of the vertical arrow are the actual procurement skills. A comparison between the competencies of Mulder et al. (2005) and the skills of Tassabehji & Moorhouse (2008) is made in Table 5.3 The purchasing competencies can be compared with the technical skills, which are both about the true purchasing skills. The technical skills are about the fundamental and basic administrative skills, including the advanced procurement process skills. As can be seen in Figure 5.2 are this the actual procurement specific skills concerning the procurement function.

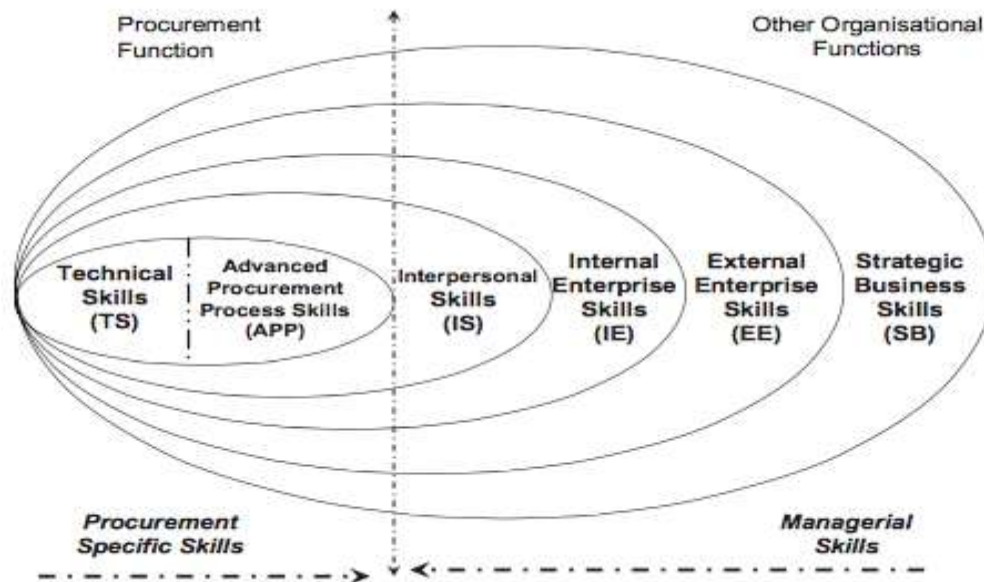


Figure 5.2: New categorization of skill types required for procurement (Tassabehji & Moorhouse, 2008)

All the other skills are focused on general management and other functions in the organization. The interpersonal skills are about interactions with people both in teams and on an individual level. Those skills can be compared with the advising and networking competencies of Mulder et al. (2005). The internal enterprise skills relate to the different interactions between the functions and to interactions within the overall business. As was explained in chapter 2, does the purchasing department have a supporting function in the value chain, as it can play an important role in each primary activity. Therefore good interaction between the purchasing department and other departments is very important. To have a good interaction are, among a communicative supportive internal organization and high quality information, human resources, including skills, the main elements (Wynstra, Axelsson, & Weele, 2000). For example, the interaction between the purchasing department and a product development team. However according to Edmonson & Nembhard (2009) is the role of purchasing in a product development team often on an adjunct basis. The internal enterprise skills can be compared with the information management, customer orientation and networking competencies of Mulder et al. (2005). Looking at Table 5.1 again, is the purchasing manager very important for

the communication with internal sectors (++), and are the senior buyer, buyer and assistant buyer important (+). So all different purchasing jobs have to be involved in internal communication, but the purchasing manager is most important.

External enterprise skills are the opposite of the internal enterprise skills and relate to interactions outside the organization like the supply chain or supply network and its stakeholders. For example, recently the purchasing executives started to understand the possibilities of involving supply chain partners to create product and process innovations (Ganesan, George, Jap, Palmatier, & Weitz, 2009). As was discussed in chapter 4, a competitive advantage could be achieved when firms focus on a long-term instead of a short-term relationship with key suppliers (Carr & Pearson, 1999). To develop a competitive advantage, it is important to maintain a healthy relationship with suppliers. The external enterprise skills of the purchasing professional are really important in maintaining those relationships. The negotiating, legal-solving abilities and networking competencies of Mulder et al. (2005) can be compared with the external enterprise skills. Looking at Table 5.1, is the senior buyer very important for the communication with external sectors (++), and are the purchasing manager and buyer important (+). So the purchasing manager, senior buyer and buyer are all involved in the external communication, but the senior buyer is most important. And finally the strategic business skills are about how the purchasing department really can add value to the organization and the strategic issues that are concerned with that. The competencies of Mulder et al. (2005), which take the overall organization into account, can be compared with the strategic issues. The competencies that take the overall organization into account are the integral thinking, analytical abilities, and generalizing and financial management competencies.

Skills (Tassabehji & Moorhouse, 2008)	Competencies (Mulder et al. 2005)
Technical Skills	Purchasing
Interpersonal Skills	Advising, Networking
Internal Enterprise Skills	Information management, Customer orientation, Networking
External Enterprise Skills	Negotiating, Legal-solving abilities, Networking
Strategic Business Skills	Integral thinking, Analytical abilities, Generalizing, Financial management

Table 5.3. Comparison between both models (Mulder et al. 2005) (Tassabehji & Moorhouse, 2008)

Examples of strategic business skills are the planning and management of strategic partnerships and risk management. By properly managing the risk and strategic partnerships the purchasing department can be of real additional value to the organization (Tassabehji & Moorhouse 2008). Carter et al. (2000), who develop a list with 18 trends, which will have an effect on the purchasing profession, came up with the same conclusion. Carter et al. (2000) concluded that purchasing professionals will need more training in general management than they needed in past. So the overall conclusion of these different articles is in line with the trends that were discussed earlier. To be more strategically important, the purchasing professionals need to

possess a lot of managerial skills next to the specific purchasing skills. However the importance of the true purchasing skills should not be underestimated. According to Ambe & Badenhorst-Weiss (2012) does cost-effective procurement depend on the skills of a specialist. The specialist has to determine buying requirements reliably, develop appropriate contract strategies, manage contracts well and seize opportunities to make sure the best deals are secured at the right time and right price (Ambe & Badenhorst-Weiss 2012).

In case study 5.2: Koopmans Koninklijke Meelfabrieken BV an example of multiple skills a purchaser has to possess is given. This example focuses on a financial background for the purchasers, and it shows that to be a good purchaser, in most situation more is required than only purchasing skills.

Case Study 5.2: Koopmans Koninklijke Meelfabrieken BV

In a guest lecture Bauke Wierda, Manager Purchasing of Koopmans Koninklijke Meelfabrieken BV, gave an example of the importance of multiple skills in practice. This example is not about the strategic skills a purchaser should possess, but in his department a lot of purchasers had a financial background. And he told that because of the growth of the purchasing departments, a lot of people with financial backgrounds start working in purchasing positions. Because of the difficult future contracts, the explanation of these contracts is beyond the scope of this book, where the purchasers of Koopmans Koninklijke Meelfabrieken BV have to deal with, is a financial background an advantage for the purchasers. This example of Bauke Wierda is in line with the financial management skills a purchaser should possess of Tassabehji & Moorhouse (2008), they also state that it is important for a purchaser to be able to make decision in the financial margin of an assignment, project or department.

The skills a purchasing professional should possess are discussed in this paragraph. The main conclusion is that the purchasing professional of today should possess a lot of managerial skills next to the purchasing skills. The next paragraph will discuss how these skills can be developed skills within a company.

DEVELOPMENT OF SKILLS FOR A PURCHASING DEPARTMENT

Professional purchasing skills are not self-evident for a purchasing department. Especially when it comes to ‘strategic purchasing’, practitioners and academics are increasingly more beginning to perceive skills as important. ‘Research has emphasized that with the changing role of purchasing, higher levels of skills, responsibilities, and professional efficiency is expected of purchasing professionals’ (Feisel, Hartmann, & Giunipero, 2011, p.63). It has been described earlier what kind of skills are needed to achieve purchasing competence. The kind of skills needed also differ for the specific tasks the department has. How do you obtain these skills as a company? Literature in development of purchasing skills is very recent and is not very extensive (Knight, Tu, & Preston, 2014; Feisel, Hartmann & Schober, 2008). However with existent literature a good investigation of the topic is possible. In this paragraph several ways are discussed for purchasing departments to attain strategic purchasing skills, by developing these themselves.

Identifying the necessary skills

Traditionally, the process of developing skills starts with identifying which technical skills and knowledge are needed exactly, called job profiling (Knight, Tu, & Preston, 2014). This typically happens by current job-holders or their line managers, sometimes also external information is used. It is time-consuming and resource intensive, outcomes can be highly subjective and therefore validity is questionable (Knight, Tu, & Preston, 2014). However job profiling is essential in developing skills. To overcome the burden of cost and also to improve the HRM process, before implementing it, a framework for determining the relevant skills for the purchasing situation is needed (Knight et al., 2014). Knight et al. (2014) identified three purchasing types which they, among others, link to the Kraljic' matrix (Kraljic, 1983). This matrix is explained in Chapter 3. The three identified types are:

- Strategic purchase
- Tactical purchase
- Routine purchase

These correspond to respectively to Kraljic' matrix (1) strategic items, (2) leverage items, (3) routine items (Knight, Tu, & Preston, 2014). There was no type corresponding to the bottleneck items, the researchers gave no explanation for this. For each type different sets of skills are needed. For a strategic purchase type, skills coordination and communication are important because of the desired mutual adjustment with the supplier. Furthermore, it is notable that decision-making skills, strategic thinking, managing internal customers, and ability to work in teams are key skills which distinguish this type from the other two. The tactical type, has less supply risks, but the necessary skills are similar to that of the strategic type. The skills necessary for the routine type are distinguished by, forecasting and target costing. This is in line with the reasoning of the Kraljic' matrix that for routine items focus should be on cost.

A lot of skills are important for more than one purchase type, but the reasons are different. For example, forecasting is a vital skill (i.e. ranked in top 10) for both Strategic products and Routine products, but the likely reasons differ. 'High storage risk, rapid evolution of required technology, and frequent design changes could necessitate accurate forecast of future demand for Strategic products, while consolidating purchases to gain economies of scale and reducing administrative cost would lead to the application of forecasting skill when managing Routine products' (Knight, Tu, & Preston, 2014). While the support is not very strong for every single relation between type and skills, the approach of fitting skills to profit impact and supply risk is relatively new and useful, it is an integration of job profiling and portfolio management (Knight, Tu, & Preston, 2014). Managers can compare their personnel and department to the skills needed in their situation, and the approach gives a quick advice in what to do in changing environments.

Developing professional purchasing skills with human resource management

The development of skills is a topic that has a lot to do with Human Resource Management. Feisel et al.(2011), linked several HRM instruments to the skills identified by Tassabehji and Moorhouse (2008)/ These are discussed in paragraph. They reflect the requirements of modern purchasing professionals: technical, interpersonal, internal enterprise, external enterprise, and strategic business skills. The first two groupings of skills are the fundamental skills needed to conduct elementary purchasing tasks. Technical skills build the foundation for more strategic skills and are the basic administrative skills needed by every purchasing professional.

There are a lot of different HR instruments however, with different costs and effects. Just imagine; coaching, training, installing a new Chief Purchasing Officer, recruitment, career path plans, those are all HR instruments. How should you apply them in practice and which circumstances are ought to be considered? The main goals of HR instruments with respect to purchasing are (Feisel et al., 2011):

- To improve performance of purchasing at different levels
- Enhancing the integration of the department with the organization, by improving skills and status.

The second point is confirmed by Bals et al. (2009), who state that low skills and status, among others, reduce integration.

Feisel et al. (2011) conducted a longitudinal case study among 4 decentralized purchasing departments that are members of a big European multinational. In order to improve their proficiency these departments had implemented several HR instruments. The various implemented HR instruments were grouped in four categories, according to the level at which performance is affected (Lynham et. al 2004; Garavan, 2007; Holton, 1999) (Feisel et al. 2011):

- Individual performance: Individual skills and competencies
- Group/social performance: Interaction in teams
- Process performance: The activities required to produce products/services
- Organizational performance: Relates to strategic issues and overall financial outcomes

Group	HR instruments
Individual	Recruitment, performance appraisal, training, personal development plans, coaching and mentoring
Group/social	Internal workshops, job-rotation, cross-functional workshops
Process	Standardized job profiles, standardized procurement processes, IT-tools
Organization	Top management support, assignment of new CPO, organization of the purchasing function

Table 5.4: HR instruments in categories (Feisel et. al, 2011)

To explain and illustrate how different performance levels are affected by HR instruments the standardized job profiles are used as an example. This is an instrument in the category of individual performance. These profiles define the necessary educational background, competencies and skills for the job. Doing so they could harmonize certain job functions and create clarity in the various activities. This was also found by Giunipero et al. (2006), tactical and strategic purchasing are divided in different jobs to create a more strategic purchasing department. So organization structure has a considerable influence on job profiling. This can be seen in Gasunie (Weterings, Gasunie). A summary of job profiling is given in Table 5.5 where also the degree of occurrence among the case-study departments is mentioned.

HRD instrument	Key driver	Degree of occurrence	Impact on skills(Tassabehji & Moorhouse)	Interdependence with other domains
Standardized job profiles	Need for standardization of key functions	Irregular , infrequent	Technical skills; internal enterprise skills	Individual performance by establishing organization-wide competency profiles

Table 5.5: HR instruments with performance outcome drivers (Feisel et. al, 2011)

As said, the status of the purchasing department is a prerequisite for integration, which in turn is necessary for good performance. The status of a department was in several companies improved by installing a new CPO. With the increased status, the department was perceived as a serious partner in business. Thinking in the identified configurations of Tassabehji & Moorhouse (2008), the department was changed from being capable to being strategic.

Interestingly, today in some companies the purchasing department gets the responsibility for buying in HR as well, it is an interesting question if this will affect the ability to develop the purchasing department. This can be seen in the following case study of Giunipero L.C. This is also an interesting practical case study about how skills of the purchasing department can be improved through an extensive HRM-plan. In the plan, purchasing employees are educated according to four skill levels in ascending order. It is interesting to see that in level 1 and 2 , technical skills remain most important, but that in level 3 the capability to deal with a broader range of topics(production planning etc.) becomes important. This corresponds to internal enterprise skills. In level 4, strategic skills become more important. This ascending order in skills is also found in literature(Giunipero et al., 2006; Mulder et al., 2005; Tassabehji & Moorhouse, 2008)

Case Study 5.3: Developing skills (Giunipero L. C.)

One highly successful firm has imbued its corporate culture with training. Each employee is required to invest a minimum of 40 hours in training per year. Top management has created a learning culture that motivates employees to renew and grow. The idea that “we have always done it this way” will not succeed in this change driven environment. Employees are described as seeking, embracing, and driving change. The firm’s commitment to education extends to its purchasing organization. A structured supply chain management program has been developed. The basis for developing skills is a four-level competency model. At Level 1 “Basic,” the employee is focused on doing his or her job and performing the attendant tasks. Level 2 is titled “Improving,” and the employee is expected to develop his or her skill set by attending courses and performing certain activities. Level 3 “Succeeding” requires familiarity with tactical skills and more demanding goals at the business unit level. Level 4 “Leading” is the highest level, and it requires a visionary and strategic focus on a corporation-wide basis. Implementing this program requires the identification of leading practices and the establishment of training that supports these practices. Pre- and post-assessments are done on the training courses, and the assessments are tied to the performance measurement program. The program’s goals are to support the development of best practices. The key items, which make the program, are the following:

- The program is coordinated across business units.
- New employees, workers hired from outside, and suppliers are included in the training.
- Upper management, business units, and individuals support the program.
- The program is phased to cover non managers, managers, and upper management.
 - Flexible ongoing training is provided in an accessible environment.
- The program is tied into performance appraisals and business unit or corporate metrics

An example of the skills required is described for the buyer/planner position. Level 2 employees would be required to complete two American Production and Inventory Control Society (APICS) modules or one C.P.M. module.

Level 3 employees would complete course work in EDI/electronic commerce, logistics, production planning, and risk management. The employee is also required to be a member of one cross-functional team. In addition, each may participate in or attend a trade show. Level 4 requirements increase to advanced negotiations, program/project management, contracts, global purchasing, and statistical applications in materials management. These individuals now get to demonstrate their knowledge by teaching a supply chain management class for half a day. Further activities include a supply chain conference, a plant tour, or participation with a consortium partner.

Alignment with strategy through performance measurement

Previous two sections examined how departments can change and improve their skill-set and how the purchasing circumstances influences the kind of skills that are needed. However, a more practical system that evaluates the performance of the purchasing department and set a direction towards strategic goals is needed. Now will be examined how a purchasing department can achieve strategic competence, specifically by a solid Purchasing Performance Measurement System (PPMS). Performance measurement is essential to HRM according to Carter & Narasimhan (1996). In chapter 4 performance measurement was examined in relation to

supplier relations. This was already an indication that performance measurement is an important driver of the professionalism of the purchasing department.

Operationally it is clear what a PPMS is; ‘PPMS use specific measures to set performance targets in line with strategic goals and to quantify the attainment of these goals’ (Pohl & Förstl, 2011, p.231). In general these metrics can be divided in two classes; efficient and effective performance metrics (Li, 2014). Effective measures measure how well purchasing is done, so, how competent the purchasing department is.

Knowing this, the use of PPMS can be lifted up to the strategic level. Recent research (Pohl & Förstl, 2011) generated an academic view on how to identify the skills and practices needed to become a strategic purchasing department. In summary, their theory is that the PPMS creates strategic purchasing competence through enhancing alignment of purchasing practices with purchasing strategy. Through learning from the info PPMS gives, firms can develop the skills necessary. Starting point here, according to Neely et. al (2000), is the strategy of purchasing. ‘The goal is to create alignment by influencing purchasing employee behavior to follow purchasing strategy and hence corporate strategic goals’ (as cited in Pohl & Förstl, 2011, p.232). Employee behavior should, among others, be understood as the use of certain skills.

A PPMS has five roles that need to be considered (Franco-Santos et al., 2007) :

- (1) Strategy management: comprises planning, strategy formulation, strategy implementation/execution, and focus.
- (2) Measure performance: encompasses monitoring progress and performance measurement/evaluation.
- (3) Influence behavior: encompasses rewarding or compensating behavior, managing relationships and control.
- (4) Learning and improvement: refers to feedback, double-loop learning and performance improvement.
- (5) Communication: includes internal and external communication, benchmarking and compliance with regulations.

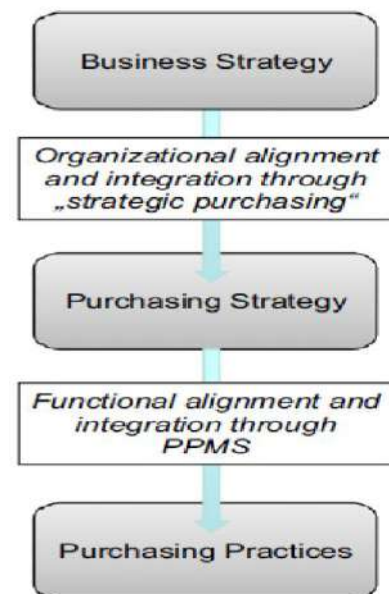


Figure 5.3: Internal alignment to strategy (Pohl & Förstl, 2011)

Through each of these roles, PPMS has influence on the practices, as can be seen in figure 5.5. Next, will be discussed how these roles relate to each other (Pohl & Förstl, 2011).

To begin, (Role 1) performance measures should be derived from purchasing strategy and reflect objectives inherent to corporate strategy. (Role 2) Furthermore performance measures should make the effects of executed purchasing practices on strategic goal attainment visible. (Role 3) Purchasing performance measurement systems should motivate purchasing staff behavior so that their purchasing practices become aligned with strategy. (Role 4) By demonstrating the effectiveness of purchasing practices, measures in PPMS contribute to the learning experience (Role 5) the performance outcomes are communicated to executive management in order to reflect on the strategic contribution to the company by the purchasing department. .

In reality, purchasing departments often only incorporate financial measures, and no non-financial measures. Doing so they tend to ignore certain strategic objectives that are only measurable with non-financial items (Pohl & Förstl, 2011). It also shows an old-school way of purchasing in that only cost-saving, which is the ultimate goal of financial purchasing measures, is considered. Furthermore, besides this rather theoretical framework, PPMS can deliver a reduction in administrative workload for purchasers by streamlining the procurement process and this gives them more time to spend on strategic tasks (Pohl & Förstl, 2011).

This paragraph revealed that it depends on the purchasing situation, which skills are needed. Furthermore HRM was identified as the way to develop these skills. A professional department guides this by a solid performance measurement for strategic alignment. However, there are more factors that ought to be considered. The increasing globalization has its effects on specific skills. This will be examined in the following paragraph.

GOING GLOBAL

When talking about Purchasing at a Global level it is necessary to recognize and develop some extra skills and tools to enable companies to be successful with their purchases. That being said, the department needs to be prepared to deal with different cultures and different perspectives about the purchasing function. This paragraph presents some evidence that highlights the importance of understanding and adapting to the suppliers' culture and a possible solution to deal with global purchasing for multinational companies. The role of the purchasing department, its status and level of professionalism perceived, also varies depending on the country so this is also discussed in this paragraph in order to identify the procurement effectiveness, meaning, what type of purchasing department you will be dealing with.

Cultural differences and consequent skills needed

Regarding cultural differences between suppliers from different countries the Hofstede's national cultural dimensions was identified as a tool to give an insight on the suppliers' culture. Although Hofstede's dimensions have been criticized (Baskerville, 2003; Ailon, 2008 cited in Perner et al. 2014), this model has been applied numerous times in the more diverse areas holding a strong position in the culture-related literature.

Hofstede (1980, 1999 cited in Perner, 2014) conducted a large-scale empirical study where he identified and conceptualized national, work-related culture in four dimensions: power distance, uncertainty avoidance, masculinity vs femininity and individualism vs collectivism. The dimensions are described subsequent in Table 5.6. (www.geert-hofstede.com/dimensions.html)

Power Distance	Refers to the degree to which the less powerful members of a society accept and expect that power is distributed unequally.
Uncertainty Avoidance	Discusses the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. The fundamental issue here is how a society deals with the fact that the future can never be known
Masculinity Vs Femininity	This dimension states that the masculinity side represents a preference in society for achievement, heroism, assertiveness and material rewards for success. Society at large is more competitive. Its opposite, femininity, stands for a preference for cooperation, modesty, caring for the weak and quality of life. Society at large is more consensus-oriented.
Individualism Vs Collectivism	This dimension defines individualism as a preference for a loosely-knit social framework in which individuals are expected to take care of only themselves and their immediate families. Its opposite, collectivism, represents a preference for a tightly-knit framework in society in which individuals can expect their relatives or members of a particular in-group to look after them in exchange for unquestioning loyalty.

Table 5.6: Hofstede Dimensions (www.geert-hofstede.com)

Various authors applied Hofstede's dimensions in their studies regarding purchasing. It was indeed proven that national culture influences the buyer-seller relationships, the make-or-buy decision and the willingness to outsource (Ogdena, Rossettib, Hendrickc, 2007); Perner et al., 2014). To be more specific, concerning the power distance dimension Dash (2009; cited in Perner, 2014) stated that buyers in cultures with high scores of power distance focus more on tangible attributes. Other findings related to the uncertainty avoidance dimension reported that cultures with high scores in this dimension tend to be more likely to repurchase from existing suppliers and use governance modes, such as market monitoring, to a greater extent than buyers in cultures with lower levels of uncertainty avoidance. (Homburg et al., 2009; Sully de Luque and Javidan, 2004 cited in Perner, 2014). Since this dimension expresses the reluctance to accept change incorporating changes in the buyer/supplier relationship may be difficult cultures with high scores in this dimension. (Ogden et al., 2007). Lastly, regarding the masculinity/femininity dimension, it influences the way purchasing relationships will be managed; with masculine cultures favoring contractual and control-based relationship between partners and feminine cultures relying on more trust-based relationships (Perner, 2014).

This model is updated and can be consulted in the author's website (www.geert-hofstede.com) where is also possible to learn more about the dimensions, check the results of the countries included in the study and compare the results from different countries.

Hofstede's national cultural dimensions should be used in order to enable the purchasing department to understand better the suppliers' culture and adapt their approach in case it is necessary. The skills to deal with cultural differences are mainly soft skills and are developed and applied by other departments who deal with the same situation.

To deal with cultural differences the purchasing department should be aware of the cross-cultural skills needed when developing a relationship and making business with different cultures. Cross-cultural competence is defined as the ability of individuals to function effectively in another culture" (Johnson, Lenartowicz, Apud, 2006 p.526). Consequently cross-

cultural skills allow international business to be successful in their international trades by smooth interaction between partners/employees/clients from different cultures and regions. In both Table 5.7 and 5.8 a list of cross-cultural competences are presented, being divided in relations and communications skills and organizational effectiveness skills.

Cross-Cultural Relations and Communications
• Positive attitude toward change and new environments
• Recognize and respect people's diversity and individual differences
• Enjoy working with diverse populations
• Comfortable working with people from different cultures
• Outgoing individual, personable, able to develop close relationships quickly
• Adept in new environments and at understanding the motivations of others
• Seek opinions of others when making decisions
• Able to relate to and interact with people of differing personalities and backgrounds
• Able to notice details that others might normally miss
• Sensitive to economic considerations and human needs
• Able to cope with constant change
• Broad background and knowledge of world affairs and cultures
• High degree of physical stamina; excellent and robust health
• Able to adjust to and fit into different situations
• Significant experience in and enjoyment of intensive cross-cultural environments
• Maintain composure under close public scrutiny and criticism.

Table 5.7: Cross-cultural skills to communicate and develop relationships (Hachey, 2004)

Organizational Effectiveness in a Cross-Cultural Environment
• Enjoy cross-cultural work environments
• Adept and attracted to multicultural environments, both social and professional
• Thrive in a culturally diverse workplace
• Diplomatic skills and sensitivity to different management styles
• Understanding of work within the culture of the group, including multicultural work groups
• Sensitive to the dynamics of a cross-cultural workplace
• Maintain effectiveness under difficult circumstances
• Able to pursue goals when difficulties arise
• Able to operate successfully in different settings and to adapt to a wide range of situations
• Good listening, clarifying, questioning and responding skills
• Remain focused on obtaining results when facing delays
• Tolerant, curious and appreciative of different work patterns while remaining committed to deadlines
• Think critically and act logically to evaluate situations, solve problems and make decisions
• Able to respond quickly to changing circumstances
• Maintain composure in stressful situations or when under pressure
• Sensitive and aware of how one's actions may affect others
• Open to different viewpoints, techniques and methods of operations
• Able to organize and work in a sensitive manner with people from other cultures
• Enjoy challenges and tasks that require a special or extra effort

Table 5.8: Cross-cultural skills to achieve organizational effectiveness (Hachey, 2004)

A possible solution to deal with cultural differences and the example of a company that uses it is presented in case study 5.4.

Case Study 5.4: International Procurement Offices

One of the possible solutions to deal with cultural differences that can turn the selection of suppliers easier and the negotiation smoother is an international purchasing office; being recognized in the sequential process models IPOs as a necessary step and a form of organizational structure needed by firms to implement their global purchasing strategy by providing an important foundation since almost all of the models identify the establishment of an IPO after the initial stage of international sourcing (Jia et al., 2014).

Other authors (Monczka and Trent 1992, Goh and Lau 1998, Avery 2002a, 2002b, Carbone 2002, Porter 2003, Pedersen 2004a, Bendorf 2005 cited in Nassimbeni & Sartor, 2006) also analyzed what are the functions of an IPO.

Many functions were identified: operations support since IPOs can provide a general support to the activities carried out abroad and commercial benefits. Regarding the suppliers an IPO has the function of their selection and development, the cooperation in product development, (“IPOs can share product development activities, as they are close to suppliers and informed about the headquarters’ requirements at the same time” cited in Nassimbeni & Sartor, 2006, p.495) and the supplier performance check. At a global level there it was identified as a function the reduction of the cultural gap. (Nassimbeni & Sartor, 2006).

The electronics company Toshiba announced the existence of 11 international procurement offices worldwide. With this, the company intention is to establish the best procurement system through a worldwide network, IPOs not only find excellent new suppliers from around the world, but also provide our business bases with daily procurement services. The location of these IPOs is described in Figure 5.4, where is noticeable the presence in three different continents: Europe, Asia and America. (<http://www.toshiba.co.jp/procure/en/ipo/>)



Figure 5.4: Distribution of Toshiba’s IPOs worldwide (<http://www.toshiba.co.jp/procure/en/ipo/>)

The functions carried out for the different IPOs are disclosure in the company’s website, in title of example, according to Toshiba the Singapore IPO has the following sales points:

“Handling various kinds of components such as passive components/semiconductors/printed wiring boards/mechanical components with competitive price.”

(<http://www.toshiba.co.jp/procure/en/ipo/>)

The purchasing department status and professionalism around the world

Due to cultural and macroeconomic effects, besides having to deal with different cultures while doing business it is also important to understand and recognize that the purchasing function is not seen nor developed the same way across the globe and it may be more respected and skillful in some countries (Yaconi, 2001 cited in Ogden et al., 2007).

After describing the profession and purchasing department in the first paragraph of this chapter it is time to look at how purchasing is seen inside the companies, and how its status and professionalism vary worldwide. As mentioned in the previous paragraph, the status can be enhanced by skilling the purchasing department (Bals, Hartmann, & Ritter, 2009). Cousins et al., 2006 (cited in Tassabehji & Moorhouse, 2008) has verified through his empirical study that internal status and role integration within the company are important precursors to attaining strategic procurement.

A study developed by Ogden et al. (2007) analyzed the purchasing status within the organization and the perceived professionalism and skills needed in the department.

Seven Countries were chosen to be part of this study (Belgium, Canada, France, Germany, Hungary, the United Kingdom, and the United States) because of the cultural and economic differences and the enablement of data collection.

The results of this study are present in the Table 5.9 where we can see that Hungary is the country with less professionalism between the countries studies, however when it comes to the purchasing status Belgium has a lower status than Hungary, another surprising result is the low status level in countries like Germany and United Kingdom (Ogden, 2007).

Status differences across countries		
Country	n	Statistically significant results (based on pairwise comparisons of adjusted mean with $p=0,10$)
UK	49	< France, Hungary and USA
Germany	50	< France, Canada, Hungary and USA
Canada	48	> Germany; > Hungary
USA	29	> Germany and UK
Hungary	22	> Belgium, Canada, Germany and UK
Belgium	89	< Hungary
France	42	> Germany and UK

Professionalism differences across countries		
Country	n	Statistically significant results (based on pairwise comparisons of adjusted mean with $p=0,10$)
Hungary	49	Less Than all
UK	50	> Hungary; < Canada and USA
Germany	48	> Hungary and UK
France	29	> Hungary
Belgium	22	> Hungary
USA	89	> Hungary and UK
Canada	42	> Hungary and UK

Table 5.9: Status and Professionalism differences across countries (Ogden et al., 2007)

Regarding the status within the organization it was recognized as a key determinant of purchasing's strategic influence and examines how integrated the purchasing function is. It was stated in this study that the status of purchasing is influenced by the country in which the

department is located, by the organizational culture and, consequently, it influences the degree of integration in the strategy forming process (Ogden, 2007).

Concerning the professionalism of the department, as stated earlier in the paragraph about skills, as purchasing becomes more strategic, it requires more qualified workforce; it's expected that the purchasing personnel has training and is aware of new tools and techniques in order to increase the effectiveness and efficiency of their supply bases. This research presented by Ogden et al. (2007), reported that level of professionalism could be influenced by the amount of resources the organization possesses. Another factor contributing for the inequality of professionalism is the non-existent presence of, purchasing training organizations, such as the Institute for Supply Management or the International Federation of Purchasing and Supply Management, in some nations, hindering the access of new skills and knowledge.

More than understanding the concepts and how they differ in the different cultures this chapter introduces a matrix developed by Tassbehji & Moorhouse (2008) that allows you to recognize the procurement effectiveness by analyzing the status of purchasing within the company and the developed skills that the department possesses. The authors described the department status in terms of the support that the top management gives to the department, because this will impact both the attitude of the organization and the resources allocated; as for the skills they need to be developed in order to achieve a high status even apart from the organization, on the horizontal axis the skills presented are in line with the ones presented on figure 5.4 that refers to the core procurement skills as the ultimate level of skills that enable the department to operate at a strategic level.

The matrix is presented in Figure 5.5 and describes four types of purchasers.

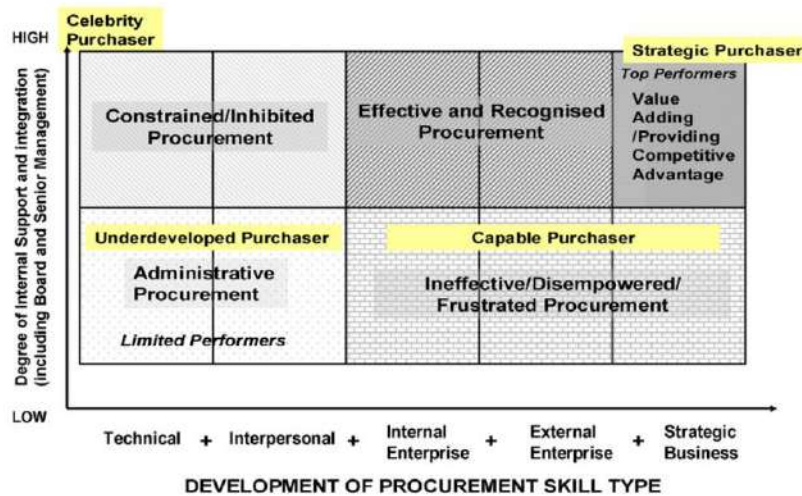


Figure 5.5: Procurement effectiveness matrix (Tassabehji & Moorhouse, 2008)

A strategic purchaser is considering the top performance and is accomplished when the department possesses all the different types of skills presented and has a high degree of support and recognition in the organization. The set of skills and its status provide a competitive advantage and adding value to the company. The capable purchaser shows how the status can disempower the procurement professionals, though they possess all the skills necessary they are not able to achieve a strategic level due to In contrast, the celebrity purchaser has the organizational support but lacks skills to become operate at a strategic level; this is actually the type of purchaser that contributes the least. Finally, the underdeveloped purchaser does not require most of the desirable skills presented in the matrix nor has the organizational support.

After analyzing the studies presented it is possible to recognize that the skills developed by the department, on their own, can still limit actual or perceived effectiveness of the purchasing performance if the status and level of support from top management are not high (Tassbehji & Moorhouse, 2008). This may be the case of Germany and UK companies that don't recognize purchasing as a high status department (Ogden et al., 2007).

CONCLUSION

The purchasing profession is evolving and there are multiple trends that have an influence on the purchasing profession. Two of the most important trends are the purchasing department becoming strategically more important to companies and the globalization effect. Part of the profession is composed of competencies and a part of the competencies are the skills, the main topic of this chapter.

The necessary skills that a purchasing professional has to possess are also influenced by the trends that influence the profession. The consequence of the purchasing department becoming strategically more important for the skills, is that more general management skills and skills concerning other functions within the organization are necessary.

For purchasing at a global level it is essential to be aware of cultural differences that may influence the way the buyer interacts with suppliers and the skills that are necessary to deal with these differences. How the purchasing function is seen and integrated within the company has direct effect on how strategic the purchasing department might be and it is possible to identify differences between countries.

Looking at the skills, the conclusion is that a purchasing professional should possess many skills beside the true purchasing skills. Tassabehji & Moorhouse (2008, p.65) state: "today's procurement professional must be a dynamic relationship manager creating and developing cross-functional strategies and must possess internal selling, change management, supplier relationship and partnership management skills." To identify the precise necessary skills, departments can make use of the framework of Knight, Tu and Preston (2014). This ranks skills according to the position in the Kraljic' matrix. Developing these skills can be done through a wide variety of HR instruments. Although useful, literature is not very specific on this to the purchasing context.

Limitations

The main limitation to the conclusions of this chapter is that not much research is conducted on this subject yet. Therefore do some parts rely on only a few studies, instead of many studies, which had the same findings. Logically, could a conclusion based on more similar findings be considered stronger than one based on only a few studies.

Recommendation to the reader

A very clear conclusion, which is very relevant for the reader, can be made according to the literature discussed. The purchasing professional of today should possess a lot of managerial skills next to the actual purchasing skills. However, the purchasing situation does have an influence on the skills that are needed and how these skills should be developed within companies. Finally, is it important that the cultural differences are taking into account when a company wants to purchase globally. Both the interaction with the suppliers can be different in different cultures, and the way the purchasing department is seen and integrated within a company can be different.

FUTURE SECTION

The general trend we see in Purchasing, is that it is becoming more strategic and more global (Knight et al., 2014; Zeng et al., 2007). This is expected to affect the skills needed. The third paragraph identified some skills as strategic; integral thinking, analytical abilities, generalizing and financial management. The last paragraph shows that a globally operating department needs certain relations, and communications skills but also organizational effectiveness skills. These skills will become more important as the current trends go on.

Furthermore Zeng et al. (2007) state: “There is a need to know more about the people who are involved in purchasing activities and decisions yet are not seen as purchasing specialists. This issue may be further exacerbated by the blurring of functional and disciplinary boundaries. This has profound implications for the education, training and development needs of individual purchasing specialists”. HRM instruments like cross-functional workshops are therefore expected to become more important, while an instrument like training (in technical purchasing skills) should also be applied to participants in the purchasing process, outside the department. This is also an interesting challenge in the light of supplier development.

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Chapter 6

SERVICES

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Abstract:

In terms of globalization and the growing importance of services regarding the buying process, a rethinking process of the purchaser has to be applied. Buying goods differs from services and furthermore, new circumstances require adapting new skills, attributes and even new strategies of buying services. With the growing globalization, a new era of 'servitization' is introduced. This means that services are being requested more often, get more attention, are bundled with goods and contain more uncertainties on the other side. They cannot be produced ahead, which makes it difficult to estimate or measure the potential or risk behind it. Subsequently, outsourcing of services is one option to get the desired objectives done and close relationships with the service consultant gain advantages out of good communication and team play. The service contract relies on good preliminary work to build upon future service projects. Consequently, case studies have shown, that services are often classified as non-strategic decisions. Internal customers work their own contract with their supplier out and even negotiate with poor purchasing skills. Finally, bypassing the purchasing department leads to avoidable high costs and obstructs to release the full potential of buying services.

Key Words:

- **Purchasing**
- **Service**
- **Servitization**
- **Globalization**
- **Buying process**
- **Sourcing strategies**
- **Relationship Management Skills**

INTRODUCTION

Services are becoming increasingly important in many industries, because companies try to integrate the process of producing goods and providing services (Lindberg & Nordin, 2008). Roodhooft and Van den Abbeele (2006) state that the process of purchasing services is also becoming more and more important, due to an emerging services industry context, deregulation and a common tendency of increased outsourcing in both the private and public sector. Therefore, it is important to find out if there are differences between purchasing services and purchasing goods, and how these differences have impact on the purchasing process. This chapter will elaborate on the entire purchasing process that is described in depth in the previous chapters, but then with the focus on purchasing services instead of goods. The next section will explain the process of purchasing services and the differences from goods, where after sourcing strategies for purchasing services will be discussed. Subsequently, the third section will mention the relationship management for purchasing services and the fourth section will go into detail about the different skills that are needed for purchasing services in comparison to purchasing goods. Finally, the results are summarized in the conclusion and future implications are mentioned in the future section.

THE PROCESS OF PURCHASING SERVICES

Services are different from goods in multiple ways. The main characteristics of services and goods are displayed in table 1. These characteristics and differences will be briefly discussed, in order to serve as a base for the rest of the paragraph.

Services	Goods
An activity	An object
Jointly produced	No interaction
Intangible	Tangible
Production, distribution and consumption are inseparable	Production and distribution are separated from consumption
Heterogeneous	Homogeneous
Perishable nature	Non perishable

Table 6.1: Services and goods characteristics

A service is more an activity rather than an object and services are often jointly produced. This means that most of the time, there is a direct link between the service and the person(s) that are providing the service. Furthermore, the client is often involved in the 'production process'. Moreover, services are intangible in the way that they cannot be felt, touched or tasted. Therefore, it could be hard for the seller to communicate and for the buyer to test before they want to purchase a service (Roodhooft & Van den Abbeele, 2006). Hence, with services the production, distribution and consumption are one process and cannot be separated. This is not the case with goods. Another difference is that services are heterogeneous in a way that it is hard to deliver exactly the same service as last time. This is due to for instance the human involvement in the 'production process'. Finally, services and goods differ based on perishability. This means that services cannot be stored or kept in stock.

However, Vargo and Lusch (2004) state that these differences between services and goods are not that obvious. They mention for instance that many services can have very tangible results. Subsequently, for many brands that produce products, intangible things are equally or even

more important than the tangible goods themselves. Van der Valk and Rozemeijer (2009) give the example of Apple and their brand name and image. This is even more important for Apple than just producing the computers and phones. Therefore, it can be hard for a purchasing department to actually purchase services according to the purchasing process for goods. This implies that the importance of service purchasing is growing.

IMPORTANCE OF PURCHASING SERVICES

As briefly stated in the introduction of this chapter, service purchasing is becoming increasingly important because of multiple reasons. Services get a more relevant status for the purchasing process, because the simple product landscape has evolved into a more complex environment. This means that companies nowadays try to deliver more than just a product. This particular emerging trend is called ‘*servitization*’ (Vandermerwe & Rada, 1988). Servitization is defined as “the increased offering of fuller market packages or ‘bundles’ of customer focused combinations of goods, services, support, self-service and knowledge in order to add value to core corporate offerings” (Dachs, Biege, Borowiecki, Lay, Jäger & Scharinger, 2014). Furthermore, Lindberg and Nordin (2008) distinguish two different types of logics that contain a view of purchasing goods and services. The first they describe is the service-dominant logic. This view states that everything is centered on the exchange of services and that the focus has to be on the exchange of intangible resources instead of goods. The second view is called the goods-dominant logic and describes the objectification of services. This means the reduction process of services to the status of simple objects and aims at making services more tangible. So these are two separate directions of purchasing services, but Lindberg and Nordin (2008) also mention a third, more dynamic pattern. This shows that all services, no matter how complex they are, appear to undergo the objectification at a specific point in time during the purchasing process anyhow. Figure 1 shows this degree of objectification in the purchasing process. Therefore, and because of the increasing frequency and growing strategic importance of professional service purchasing, new things are asked from the purchasing department of a company (Holma, 2012).

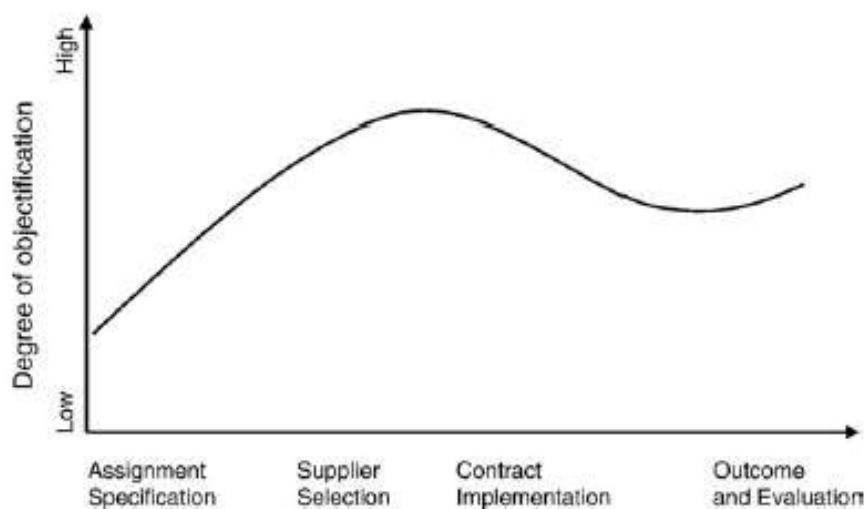


Figure 6.1: Objectification in the purchasing process (adopted from Lindberg & Nordin, 2008)

As this book is about purchasing, the purchasing process will be discussed in terms of purchasing services. The purchasing process starts with specification of the services and

selecting suppliers, but before that process actually can start, the company needs to decide whether to make or buy services.

MAKE- OR BUY DECISION IN SERVICES

The differences between goods and services have consequences for a company and the purchasing department, such as the intangibility and perishability of services. The first main decision a company needs to think about is the possibility to make or buy a service. This is called the make- or buy decision. The process and the internal effects of this decision are discussed in chapter 2. However, this decision also has to be made for services. For instance, a company and the purchasing department have to think about in- or outsourcing the cleaning or transport activities. If they decide to outsource it, the purchasing department needs to select the right cleaning or transportation company that provides this service. This implies that possibly other selection criteria are important for purchasing services than purchasing goods (Jackson, Neidell & Lunsford, 1995). These selection criteria will be explained in detail in the following section of this chapter. As can be seen in figure 1, the degree of objectification is low before and at the assignment specification stage. So at the make- or buy decision, the relatively intangible needs that are identified by the potential internal users have a low degree of objectification (Lindberg & Nordin, 2008). After the make- or buy decision this degree of objectification increases.

The company furthermore needs to decide whether to purchase services centralized, decentralized or hybrid. Chapter 2 explained the differences between these options. Ellram, Tate and Billington (2007) mention that purchasing services has a decentralized nature. This is because the services that are identified as strategic and important, most of the time, are procured by non-purchasing specialists. Examples of people who mainly purchase these services are marketers and logisticians (Ellram et al., 2007). Furthermore, purchasing non-strategic services like for instance cleaning services, can be purchased decentralized. For more strategic services, for instance a consulting service, it would be more appropriate to use a more centralized purchasing strategy, because this could help the entire company and supply chain in the way that these services are purchased at one place. This creates consistency and is therefore more easy to control and monitor for the entire company.

VALUE OF SERVICE PURCHASING

A lot of examples of purchasing services can be distinguished. For instance, cleaning services or administration services are basic services that are purchased by a lot of organizations. Furthermore, consulting services or transportation services are examples of more strategic purchased services. The services are purchased from another organization that is specialized in executing this service and provides them for the buyer-organization. Chapter 3 already introduced purchasing portfolio models to categorize and manage products. Important portfolio models are for instance the Kraljic (1983) matrix shown in figure 3.4 of chapter 3 and the van Weele matrix in figure 1.4 of chapter 1. The figure below shows a matrix that is presented by Ellram and Tate (2015). The main difference between this matrix and those mentioned in chapter 3, is that the matrix of Ellram and Tate (2015) is applied to purchasing services instead of goods. This matrix is presented below.

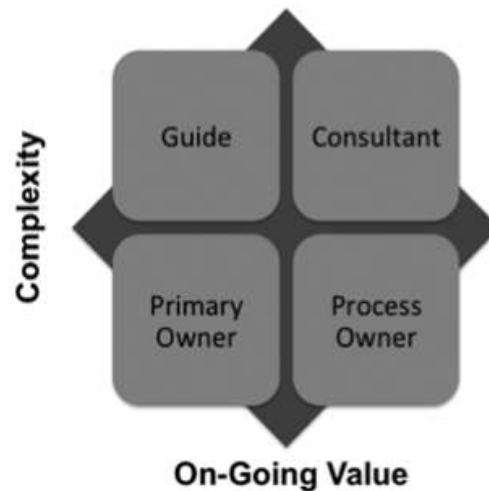


Figure 6.2: Service purchasing matrix (adapted from Ellram & Tate, 2015)

With the help of this matrix, different services can be classified according to the two characteristics ‘*complexity*’ and ‘*on-going value*’. This helps a company with categorizing the different services that need to be purchased and therefore with picking an appropriate strategy. With the ‘*complexity*’ of services, Ellram and Tate (2015) pay attention to the ownership of the budget for that service, internal and external political surroundings that services purchase, including the service beneficiary’s power, the ability to accurately specify the service and finally, the level of technical expertise needed to assess the service’s providers outcome. With the ‘*on-going value*’ of the service to the organization, Ellram and Tate (2015) consider the frequency of the purchase, the impact of the purchase on external customers, the dollar value of the purchase and the importance of the service to the organization’s success.

The bottom left corner presents the ‘*primary owner*’ services. These services are characterized as easy to specify, are often low dollar value to the end customer and frequently used by many departments or people within the organization. Ellram and Tate (2015) call the services in this quadrant the ‘*insignificant many*’ items that will be a burden if they are not managed well. However, these services are not core to the organization’s competitiveness. Therefore, this quadrant shows similarities with the ‘*noncritical items*’ of the Kraljic matrix and to a lesser extent to the ‘*nuisance items*’ of the van Weele matrix. The similarities are that these products/services all have small value to the buyer-company, but Ellram and Tate (2015) mention that they will be a burden if they are not managed well. This is not the case at the van Weele matrix, because their category has no impact on the supplier or the buyer if they are not purchased any more.

The top left corner presents the ‘*guide*’ services. These are characterized by low on-going value to the organization, but by high complexity and may be relatively important to the user. The purchases of these services have a low dollar value and they do not have an ongoing impact on the organization’s end customers. They may be important to a particular function, but in general these services are not a large part of the budget. This category can be compared partially to the ‘*leverage items*’ and ‘*development items*’ of the Kraljic- and the van Weele matrix respectively. This is because the ‘*guide*’ services are not really expensive for the company, but the two items of the other matrices do. However, the ‘*guide*’ may be relatively important to the user and this is comparable with the other matrices.

The top right corner presents the ‘*consultant*’ services. These services are characterized as complex, but are highly specified. Furthermore, these services often have emotional value

because of the importance that the budget owner values them. Subsequently, they have a high on-going value, because these services have a high dollar spend and a large impact on the internal customers and revenue. This category is highly comparable with the *'strategic value items'* and the *'core items'* of the other two matrices, because these items are strategically important, mainly complex and are of great value to the buyer-company.

The last category is the bottom right corner, which presents the *'process owner'* services. The services are characterized by a low complexity (so they have relatively clear specifications), but have high on-going value in that they cut across business units and may have some external customer impact. This category can be compared to the *'exploitable items'* of the van Weele matrix, but to a lesser extent to the *'bottleneck items'* of the Kraljic matrix. This is because the *'exploitable items'* also have a high value to the company and the *'bottleneck items'* do not.

Chapter 3 furthermore mentioned three different purchasing strategies from Kraljic (1983), namely the exploit strategy, the diversify strategy and the balance strategy. These strategies can also be applied to the Ellram and Tate (2015) matrix. The exploit strategy can be used for the *'process owner'* services, because they are a large part of the total budget of the company but the complexity is low. Therefore, the buyer-company can try to search for multiple suppliers, which offer the best quality and pick the cheapest one. The diversify strategy can for example be used for the *'guide'* services. This is because the ongoing value of these services is also low, but they have a high complexity. The balance strategy can be used for the *'primary owner'* and *'consultant'* services. For instance, the buyer-company has to try to build up a long-term relationship with the suppliers of the *'consultant'* services and just has to make sure that the *'primary owner'* services are delivered.

Case Study 6.1: Koudijs Consultancy & Management (KCM)

Koudijs Consultancy & Management (KCM) is a consultancy firm that is located in Olst in the Netherlands. They are specialized in the sport-, leisure- and healthbranche. For example, they provide audits for swimming pools. So a swimming pool buys the services of KCM and a consultant of KCM comes by once a year to check up their swimming pool on multiple criteria. They test the water slide on safety by sliding it and setting up a report with improvements if necessary. Furthermore, they also offer managerial services, like an interim management. If the management of a swimming pool cannot cope with the managerial issues, they can buy the service of KCM and they will try to guide the management of the swimming pool in the right direction. Subsequently, they also provide the buyer-company with an advice if they plan to build a new accommodation or building for instance. KCM sets up a feasibility study to give the buyer-company a clear view of the possibilities. They have different types of customers that purchase their services. Examples are: the government, sector- and interest groups, non-profit organizations, sport accommodations and swimming pools as mentioned before. It is possible that KCM only provides their services for a short time, but they also work on assignments that take on multiple years.

(Source: <http://www.kcm.nu/home>, March 2015)

A good example of a service that can be placed in the right above corner of the matrix of Ellram and Tate (2015) is given in case study 6.1. The services of KCM are bought by the buyer-

company and KCM delivers a complex service. Furthermore, the on-going value of this particular service is high, because the help of KCM is of great importance to the buyer-company.

Key challenges

Purchasing services has several challenges, just like the purchase process of goods (Axelsson & Wynstra, 2002). Although, these challenges do differ from the challenges of purchasing goods. This is caused by the different characteristics of services as explained before. One of the problems that purchasing departments of company's encounter is that services are hard to evaluate before the purchase has been done. This also influences the supplier selection negatively. Therefore, Axelsson & Wynstra (2002) suggest that issues like supplier staff competencies and 'customer skills' should be added to the current purchasing criteria. Furthermore, the costs of services may be a problem, because it is hard to put an agreeable price on a complex service. Consistent to this is the assessment of the value that is gained by the buyer-company from purchasing the service from the service provider. Another problem might be the demand and capacity management for the supplier. They need a clear understanding of the business processes of the buyer-company in order to deliver a good customized service.

Just like in purchasing goods, also in service purchasing there is a trust issue. Namely, if a company chooses to purchase services from a supplier they already know for a long time, this might cause 'overembeddedness' (Uzzi, 1997). This causes that the buyer-company sticks to the same suppliers, because they build up a good relationship. However, then they ignore the possibility of cheaper and/or higher quality service providers (Pemer, Werr & Bianchi, 2014). However, this issue is a more important issue in service purchasing because of the human factor (Pemer et al., 2014). In services humans play a larger role and this is because of the interaction in the service process. This differs from purchasing goods, because the goods that are purchased are clearly specified and already finished when actually purchased.

GLOBALIZATION PROCESS

The process of purchasing services is also influenced by globalization. Service purchasing can for instance be achieved by outsourcing services onshore or offshore. Nowadays, offshore service outsourcing is becoming easier due to relatively cheap and reliable information and telecommunication technologies (Ellram et al., 2007). However, offshore outsourcing also increases the organizational complexity and risks, because the company is exposed to for instance different cultures, law and people, among others (Aron & Singh, 2005). Examples of services that are often outsourced and therefore purchased are call centers, financial processing, data management, and accounting (Tate & Ellram, 2012). These are mainly not core functions and therefore possible to purchase offshore. Furthermore, the specification and selection of these service purchases can differ from onshore purchases and also from purchasing goods. This will be explained in more detail in the next section.

Case Study 6.2: Web1on1

Call centers are a type of services that are often outsourced and therefore purchased by an organization. This is because it mainly is a supporting service and not a core function. Thanks to the emerging technology possibilities, it is even possible to outsource the function of a call center offshore, which might be beneficial because of lower labor costs for example. In recent years another type of call center arose, namely a help service on the Internet. Web1on1 is a Dutch company that provides this help service in the Netherlands and Germany at this moment. They offer their service to companies in the automotive and in the real estate market. So, for instance car dealers and brands purchase the service of Web1on1 and Web1on1 tries to answer questions and generate leads for the car dealers and brands. This is an example of how it works: the car dealers have a website on which they sell used cars. A visitor sees an interesting car and has some specific questions about the car. Of course it is possible for the visitor to call the car dealer and ask the questions, but Web1on1 offers the service of being online from 9 am till 11 pm. Therefore, a chat box pops up at the screen of the visitor and he/she can ask the questions directly to one of the chat operators of Web1on1. They try to answer the questions or try to sell the car. Finally the entire transcript of the chat is send to the car dealer along with the contact information of the visitor. This gives the car dealer the chance to contact the visitor and sell the specific car. The chat operators are employed throughout the Netherlands and are able to work wherever an internet connection is available. This is therefore a good example of the influence of globalization on service purchasing. The car dealers are also located throughout the Netherlands, so there is no direct contact between the chat operators and car dealers. This is made possible by the advanced technology of today. Examples of companies that purchase the service of Web1on1 are: Fiat, Mini, Skoda, Mercedes-Benz, Garantie Makelaars and ERA Real Estate.

(Source: <http://www.web1on1.com/>, March 2015)

A good example of the influence of globalization for service purchasing is given in the 6.2. case study about the company Web1on1. With this service, companies in the automotive and real estate market are able to have contact with new or existing visitors, without hiring or training new staff. Furthermore, this service can be provided throughout the entire world, because the only thing that is needed is a proper Internet connection. Therefore, Web1on1 can provide their service at a low price, because they do not need to hire a large office for instance.

SOURCING STRATEGIES

Specification

Out of chapter 3 about sourcing, several important aspects crystallized to the surface. Reductions of costs are aspired with the positive by-product of maintaining or even improving the quality of products/services. The understanding about sourcing strategies has to be available in order to improve the value-to-price relationship by achieving cost reductions for reaching improvement of quality of services (Hallikas, Immonen, Pynnönen, & Mikkonen, 2014). Supplier relationships have to be examined throughout the whole organization. It can be seen as hard to assess the quality of the services, because the buyer-organization does not know how the service process will develop. Measurement is not easy to define, but it might be a good approach to define some stages of service agendas. Mitchell (1994) mentioned that the “*purchase of services can involve a lot of time, money, and personnel without any guarantee of a successful outcome*” (Mitchell, 1994, p.316). Most of the expertise, which is used for the buying process, is based on the knowledge of buying goods. This behavior can be seen very critical (Shostack, 1977; Weinberger & Brown, 1977). Purchasing process of services differs from the process of goods essentially. More risk is involved in the selection of services and so it is more complex (Montgomery & Ryans, 1973).

Selection process

Chapter 3 already distinguished five selection criteria, namely: financial, organizational culture and strategy, technical capabilities, support resource, risk involving globalization and localization. The choosing of the right service depends more as on those criteria factors. Furthermore they are defined into ‘*eight stages of problem solving*’. Stock and Zinszer (1987) introduced them in the industrial decision process for services, like a guideline for purchaser.

1. Identify the problem

Wilson et al. (1972) examined several reasons for hiring external consultants. First of all the demand for extraordinary skills must exist. According to Mitchell (1994), limitation to the own personnel or in-house capabilities is one of the most common reasons. In addition to that, legal requirements like auditing, demand of objectivity, freedom from internal pressures, absence of resources or equipment are just a few to name, to understand that this is quite complex (Wilson, 1972).

2. Determine the problem for the dimension (internal/external)

Someone within the organization has to define the objective, which has to be fulfilled and appoint an employee to “*supervise the work continually*” (Frankenhuis, 1977, p.134). In the long run it might be wise to build up own expertise, to avoid high costs of services. Fisher et. al (1990) explained this effect with the use of lawyers. Costs of in-house lawyers are 40% cheaper than external law firms.

3. Identify consultants

The right consultant has to be chosen in order to fulfill the own expectations.

4. *Search for information about consultants*

The search for the satisfaction of the demand of solution leads the purchasing department to the gathering process of certain information: “*personal sources, independent consumer reports, news articles, advertising, in store material, distributor listings, packaging information and sampling.*”(Mitchell, 1994, p.320)

5. *Evaluate and recommend consultants*

Like already mentioned, that services are not easy to measure or evaluate they are intangible as well (Parasuraman, Zeithaml, & Berry, 1985). The service quality is a subjective matter and increases the uncertainty in the purchaser’s buying decision. (Gummesson, 1978). A lot of variation exists in the unknown outcome, but with the right experience and skills, risk can be decreased to an assessable level to evaluate the consultant.

6. *Select the right consultant*

When one desired consultant is chosen, contact will follow by email or telephone. Some organizations prefer the formal way of agreement, by sending drafts to the consultants. By this they want to get first comments and first valuation of the objectives. Ulterior motive behind this is to lower the risk (Mitchell, 1994)

7. *Manage the project*

Accepted services within an organization may last several months or years, which requires a lot of commitment of the purchasing department (Mitchell, 1994). The duration of the project depends on it, to continue the work with the consultant.

8. *Review the performance*

Evaluation of professional services are difficult, because there is no right or wrong in fulfilling a service. A recommendation might be the best solution to estimate the outcome of the project and if the collaborative work has been successful.

Trust is one crucial aspect in selecting services, because the purchasing partner is relying on the best transformation of the desired wishes into the best services. The selection of the right supplier leads probably into a long-term orientated relationship. Buyer-supplier relationship depends on the selection and creation of the contract towards the goal of trust.

RELATIONSHIP MANAGEMENT

Relationships

For the procurement process of buying services it requires more than just agreements of the work. Furthermore, the purchaser needs another perspective, not on equipment and goods, more on service, which need the attention of the management. The “*new direction should be on a relationship management that secures the quality and level of series provided by the vendor*” (Abramson & Harris III, 2003, p.7). Like already stated before, that buying services is related to more uncertainties and complex structure, “old ways of operating” are no longer effective for complex activities. In the old way fashioned way it was more like that the buyer had the full control, by forcing the supplier/consultant to the direction of lowering the costs. The supplier had no other choice than doing this, what was expected from him. This resulted in just an ordinary result but not the most efficient. The “new way”, which should be entered with the

supplier of service, should be a public-private partnership, where all participants interact as equals. Public-private partnerships is “an arrangement of roles and relationships in which two or more public and private entities coordinate/combine complementary resources to achieve their separate objectives through joint pursuit of one or more common objectives.” (Abramson & Harris III, 2003, p.8). A partnership should identify goals, which should be achieved together. Trust is such a key element in an efficient relationship to realize innovative and creative ways of solutions. The relationship will evolve and even change over the time, like the same evolvement process for buying goods. Reaction should be to adjust the right amount of processes to enlighten the relationship, for long-term orientation. Best value procurement with trusting the organization that delivers the service is very important. This method notes that the service providers are the specialists, and therefore the buyer-organization needs to trust the proceedings of the service provider.

Case Study 6.3: Gasunie

An example of this trust issue is given by Gasunie. They collaborated together with Microsoft for over decades and their trust in partnership grew steadily. Gasunie paid for the services Microsoft provided. The services contained general support and licenses for software. When it came back to the purchasing process of new services, Gasunie paid Microsoft more than originally was agreed upon, by purpose. Gasunie had some spare budget and could have decided to save this budget by not spending it. However, they decided to spend this remaining money on Microsoft. Microsoft was pleasantly surprised by this and appreciated the gesture. The result was not only delight of more profit for the software provider, also the effect of strengthening mutual confidence and trust in the partnership were gained with this. Later on, when Gasunie was struggling with a certain situation, they gained Microsoft’s help when they needed assistance. Microsoft was willing to help out Gasunie with their problem, because Gasunie initially paid them more than was agreed upon. Therefore, Microsoft send their people as fast as possible to fix the problems at Gasunie. In this case, trust in their partner resulted in support and mutual comprehension.

(Ad Weterings, Sr. purchaser, Gasunie, March 2015)

Internal customer

Like in general that only little research has been done in the field of purchasing services, the impact on the internal customer services quality is unclear as well. This abstract will clarify the missing gap. Jun and Cai (2010) defined internal customer as the demanding employees within the organization for a services/goods in collaboration with the purchasing department. The satisfaction of the demand has to be served by the purchaser. Finn et. al (1996) argued that internal customers have the same importance level like the external customer does and a good service may lead to efficient organizational processes. This should result in the attempt of satisfaction and understanding of the need for services. Jun and Cai (2010) introduce the function role of the purchasing department as the following: The types of services vary from placing and tracking purchase orders, determining needs and specifications and helping to implement new technology. This exchange process between individuals of departments within an organization can be optimized to gain not just the best internal service quality, but an

improvement for the external customer as well. (Stanley & Wisner, 2001; Varey et al., 1995). It can be named ‘*service-profit chain*’ (SPC), with the main thesis that internal service quality directs to employee satisfaction and boosts not only loyalty but productivity and profitability (Heskett, Jones, Loveman, Sasser, & Schlesinger, 2008). Heskett et al. (2008) mention that profit is stimulated by customer loyalty, which results in customer satisfaction. Furthermore high-quality services leads to satisfaction, which is influenced by the value of services, offered. Value then is the end product of satisfied, loyal and productive employees. To avoid misunderstanding between internal customers and their supplier/purchaser, a common understanding of what good service quality should be, have to be developed. The perception of service quality depends on the beliefs and attitudes towards the received service (Parasuraman et al., 1988). For this enterprise to understand different characteristics of internal departments, ‘*six service quality dimensions*’ have been developed and identified by Jun and Cai (2010).

Dimension 1: Customer intimacy

Customer intimacy is related to the quality attribute of “building intimate relationships between the purchasing department and its internal customers” (Jun & Cai, 2010, p.217) Furthermore they analyzed factors which should exist in their relationship, like friendly and polite team play, personal attention in internal issues, trustworthy work and availability of employees.

Dimension 2: Reliability / Competence

This dimension from Jun and Cai (2010) emphasizes the abilities of employees to realize the promised service and of course the presence of required skills and knowledge for the service.

Dimension 3: Team-based continuous improvement

In this dimension of Jun and Cai (2010) a high quality service which is provided for the changing needs of internal customers, should meet internal customers’ changing needs, “the purchasing department should continuously improve its purchasing practices particularly through a team-based approach” (Jun & Cai, 2010, p.217).

Dimension 4: Requisition process

Purchaser have the knowledge about prices for items/services they purchase frequently and have access of previous requisitions (Jun & Cai, 2010).

Dimension 5: Communication

Jun and Cai (2010) mentioned that the purchasing department should “always help with price/quality options, search, selection” (Jun & Cai, 2010, p.217). It is one of the most important communication activities between the department and its internal customers.

Dimension 6: Tangibles

According to Jun and Cai (2010) it refers to “the appearance of physical, equipment, personnel and communication materials”.

For the organizations long-term success, those dimensions should be fulfilled in order to gain critical advantage out of it. Internal customer satisfaction is influenced by the internal service quality by the purchasing department one of the main differences of buying goods is obviously the communication and close elaboration with its internal customer. The purchasing department has to understand the dimensions of their consumers to estimate service quality, so they react to improve processes. All six dimensions should earn the same amount of attention but in terms of limited time and resources, it is recommendable that purchasing managers should focus particularly on customer intimacy, team-based continuous improvement, requisition process and communication. Jun and Cai (2010) considered that development of intimate relationships

by offering services in a friendly and trustworthy way, establishing cross-functional teams, frequently interaction to gain synergistic effects in continuously improving purchasing's service quality, might be the right way.

CONTRACT MANAGEMENT

Buying services brings up risks of the unknown, which are considered to be higher than when buying goods. For managing contracts about services, those risks should be kept in mind. During the negotiating process with the service supplier, all unsure points should be addressed like specifying services, qualifying and selecting services and even evaluating of the performance. Surprisingly, some research projects researchers indicate that CEOs tend to the thinking that purchasing of services might be easier than the purchasing goods. Hence, new or inexperienced purchaser are assigned to handle with services contracts (Van Weele & Van der Valk, 2010). Van Weele and Van der Valk (2010) even observe a by-passing effect of the purchasing department, because most of companies notice services as non-strategic. When it actually comes to the process of buying strategic services, non-purchasing departments do the negotiating. The internal customers usually want to maintain close relationship with the business partners and do not want annoying purchaser to interfere in this matter. This particular example shows the potential of cost savings by modernize the organization structure.

Evaluation and monitoring

One of the final stages of contract management is the evaluation and monitoring of the purchased services and of the actual purchasing process. Mitchell (1994) states that the post-purchase evaluation of services is more difficult than for goods. This is because it might be very hard to determine whether or not the problem is fixed, because there is rarely a correct or incorrect solution (Mitchell, 1994). Furthermore, Mitchell (1994) mentions that it could be hard for the buyer-company to evaluate the purchase of the service. The reason for this is that the professional service might be so technical that the purchaser lacks knowledge or skill to evaluate satisfaction. On the other hand, there might be services that the buyer-company could easily do themselves. Despite of this, these companies could decide to outsource these services, due to for instance limited resources or time constraints (Zeithaml, 1981). If this occurs, the evaluation and monitoring process of the purchases can be executed well by the buyer-company.

Looking back at figure 6.1, it can be noticed that the degree of objectification for the evaluation and monitoring phase increases according to Lindberg & Nordin (2008). Therefore, the service evaluation descriptions need to become clearer in order to judge them properly. Based on the findings of Mitchell (1994) this will not be that easy. Hence, the purchasing department of the buyer-company needs to make clear what they expect from the service and needs to communicate this throughout the purchasing and production process to the supplier.

Cultural aspects of the dimensions

The Perception of service quality varies from individuals as well as among cultural groups. In previous chapters, Hofstede's dimensions have been introduced to explain more the impact on purchasing behavior. Cultural dimensions have big influence on the perception of service quality and the understanding of customer satisfaction (Parasuraman, Zeithaml & Berry, 1985).

The six service quality dimensions provide a good insight of the different culture groups. It is useful, because with those dimensions, different approaches in allocation of resources and usage of services can be observed much better. In a case study of Winsted (1997), consumers in USA and Japan have been analyzed how they evaluated perceived service. With behavioral-based service encounter dimensions it was possible to measure cross-cultural differences. US consumer dimensions have been categorized as civility, personalization, remembering, conversation, congeniality, delivery, and authenticity. Dimensions in Japan are civility, personalization, conversation, concern, and formality. The result of those dimensions showed up overall satisfaction with service encounter. Criticism to this case study result is that it is not suited to measure the differences towards level of importance for both countries. Mattila (1999) tried to find an answer to the theoretical frame-work relating culture and service satisfaction. Out of this case study, the discovery advised that western customers tend more to rely on tangible cues from physical environment than customers in Asia. Moreover enjoyment of consumption dimension is more relevant in the western world than in Asia.

Regarding Hofstede's dimensions, "*powerful-weak customers, male-female service providers, and frequent-infrequent service situations* influence the relationships between culture and the relative importance of the service quality dimensions." (Furrer, Liu & Sudharshan, 2000, p.358). With Mattila's results (1999), statement is pretty clear that the customer have the power and control over service provider. Another case study from Donthu and Yoo (1998) argued the opposite, that service providers have the control (e.g. insurance, consulting). Control or power relate to its expertise, professional knowledge or even skills. For instance, Cultures with power distance accentuation have differences in social class, education level, and occupation. Relative importance of different service quality dimensions will vary depending on relative power of demand and offer. Another important fact in buying service and cultural expectations is the gender role and its stereotypes, personality, and negotiation. In some masculine cultures it might be difficult to explain, that a women might come along to install several software updates. Mostly Arabian cultures tend to be the normality to expect male customer support, which is seen much more professional. Female service employees are expected to be more empathic (Furrer et al., 2000). For the dimension of frequent services, customers already know the service process and its role. Infrequent service situations lead to uncertainty and ambiguity from the unknown situation. High uncertainty avoidance cultures might differ from the perception of the two types of frequency.

SKILLS

Skills required for purchasing services

In chapter 5 the different skills and jobs in purchasing were discussed. Purchasing departments give increasingly attention to purchasing services (Smeltzet & Ogden, 2002; Lovelock, 1992). However, this research as represented in figure 6.3 proves that the difference between buying services and buying goods is rather large. '*Consequently, different training, staffing, and performance evaluation systems may need to be implemented to account for these differences*' (Smeltzet & Ogden, 2002)

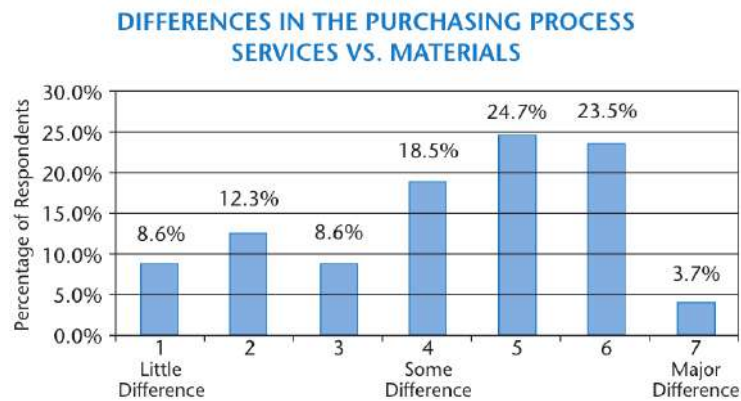


Figure 6.3: Differences in the purchasing process (adapted from Smeltzet & Ogden, 2002)

When purchasing services, other skills are required, and complexity of the purchasing process increases (Smeltzet & Ogden, 2002) partly due to heterogeneity, inseparability, perishability, and intangibility of services. Heterogeneity indicates that delivered services are different every time. Hence, no objective standard can be set for these. Furthermore, perishability indicates that services are simultaneously produced and consumed. Therefore, usage experience is the most important element in evaluating service delivered. Moreover, service is difficult to objectively evaluate. Lastly, purchasing services is much more dangerous for companies than purchasing materials or goods (Roth et al., 2004). For example, ‘*ill-conceived marketing research or advertising that misses its mark or inappropriate legal advice can all have devastating effects on a client firm*’ (Day & Barksdale, 1994). This is also indicated by the research by Smeltzet and Ogden (2002), as represented in figure 6.4.

This research shows a disturbing trend among managers regarding purchasing services. Managers often responded, in the qualitative analysis, by stating ‘*We have traditionally placed new buyers on services so they can get their feet wet.*’ On the other hand, purchasers state that ‘*Top management, and that includes purchasing management, doesn’t understand the potential waste from a bad service contract*’.

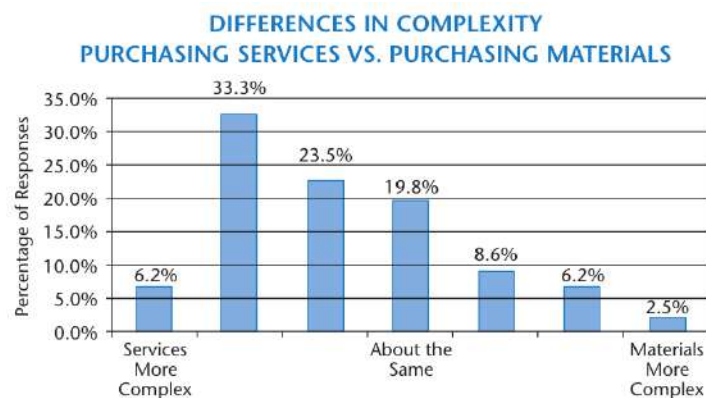


Figure 6.4: Differences in complexity (adapted from Smeltzet & Ogden, 2002)

Especially when taking the global aspect of cultural differences into account, different skills to succeed in procurement are required. Especially since purchasing services is solely about the procurement of future interaction between individuals. In the modern world of business cultural differences in purchasing services become increasingly important, as mentioned earlier. In 1999 already half of the *Fortune Global 500*’s largest 50 firms were service companies, and this number has increased ever since. Moreover, most large companies labeled as manufacturing companies have significant service components without which the company could no longer

exist. Hence, researching the aspect of purchasing services is extremely requisite. But first, relevant trends influencing the procurement of services will be taken into account. These trends emphasize the relevance of the purchasing department, especially in the future.

Relevant trends in purchasing services

As indicated in **table 1, chapter 5** several trends influence the importance of purchasing in general (Mulder et al., 2005). There are some specific trends, however, that influence the strategic importance of purchasing services (Mulder et al., 2005). Each trend has a different impact and different relevance to purchasing services.

E-business

This trend is mostly based on the information society that human beings currently live in. All information is to be found online. Even though E-business has been a trend for several decades already, the consequences are only partly visible at this moment. The Internet makes it possible to ‘*communicate, compare, commission statements, and purchase goods and services online*’. The possibilities that the Internet offer us will increase significantly approximately 10 years from now. Imagination is the bottleneck in projecting the future. E-business is expected to peak in the near future. Hence, the possibilities in effectively purchasing will increase significantly due to the almost unlimited availability of information.

Focus on core competencies

The drift of focusing on core competencies has started in the 1990s and has continued ever since. More and more products are outsourced or bought from other firms in order to be able to focus on core competencies. The outsourcing of company sections is a form of buying services, and thus heavily important.

Globalization

An increasing number of businesses choose for mergers or international partners as a result of heavy competition by globalization. Partly due to the E-business trend, geographical distance is no longer an obstacle when selecting service suppliers.

In table 1 of chapter 5, the research of Mulder et al. (2005) was used to indicate different trends that will influence the purchasing profession overall. Thus, these trends are relevant for both the procurement of goods and the procurement of services. Therefore, it is highly recommended taking these trends into account for the future job description of general purchasing skills as well.

Relevant skills for purchasing services

The skills for purchasing products and the skills for purchasing services do, however, differ. Unfortunately, there is barely research conducted about the skills required to strategically purchase services. Yet, Sonmez and Moorhouse (2010) have conducted research on the decision criteria used to select a service provider. These decision criteria can be translated to skills required to purchase services. When comparing these skills to the general skills in **figure 2, chapter 5**, particular skills, which are required for purchasing services, can be identified.

Competence	Explanation
Product features	Ability to identify whether service meets (internal) client needs
Reputation	Ability to identify reputation of service provider
International capability	Ability to estimate service's international opportunities
Expertise / Experience	Ability to identify expertise of service provider, and have sufficient expertise in purchasing themselves
Ability to measure effectiveness	Ability to measure effectiveness of service
Relationship	Have background in other fields than purchasing
Organizational capability	Organizational capability of purchaser
Knowledge and understanding	Knowledge about (internal) client and industry in which firm operates
References	Ability to identify previous work of service provider (Word-of-mouth)
Product value	Ability to identify value of service delivered
Recommendation	Ability to value recommendation from professional contacts and non-professional contacts.

Table 6.2: Skills for purchasing services (adopted from Sonmez & Moorhouse, 2010)

After comparing the general purchasing skills as proposed in **figure 2 and figure 3, chapter 5** with the service-specific purchasing skills as identified in the paper by Sonmez & Moorhouse (2010), it is noticeable that there is quite some difference between them. Thus, as an interpretation, the aforementioned skills as general purchasing skills are required to participate in the purchasing department. The skills or competences are specifically needed for purchasing services. Thereby, these competencies are also needed to identify and assess the future value of services delivered whereas the skills in chapter 5 are to be interpreted in terms of general purchasing.

Case Study 6.4: GlaxoSmithKline (GSK)

In September 2008, the GlaxoSmithKline (GSK) law department began to radically change when the company appointed a new General Counsel, Dan Troy, a firm believer that the hourly-rate billing system can promote inefficiency. This hourly-rate billing supported the wrong elements in efficient working. Troy became responsible for implementing one of the top priorities of GSK's CEO: to significantly reduce outside legal spend, while continuing to obtain excellent legal representation. Bob Harchut, head of the US litigation was asked in November 2008 to lead a new team within the law department called the Global External Legal Relations Team (GELRT). Its mission was to change the paradigm by which GSK paid for legal services by moving all outside counsel assignments throughout the world to value-based fee (VBF) arrangements whenever feasible. At first, Harchut was doubtful. However, Troy insisted that he truly wanted the arrangements to be win-win. Consequently, Harchut began by assembling a cross-functional team including Procurement, Finance, IT, and a Lean Sigma project manager to develop tools and processes. 'This was an eye-opening process,' Harchut says. Troy was willing to invest in the law department and in the initiative. Harchut hired two financial analysts to help him track metrics and chart the success of the effort. GELRT then began working with law firms, deploying a pilot with 10 major US litigation firms that represented the majority of GSK's legal spend. 'They were very receptive and willing to work with us,' Harchut says. 'That may have been due, in part, to the effects of the economic crisis at the time.' A willingness to experiment was also key. Troy and Harchut espouse an approach of 'launch and learn', believing that often perfection can be the enemy of the good.

Before the initiative began, less than three percent of GSK's external spend was through value-based fee arrangements. By the end of 2011, more than 68% of GSK's external spend was through VBF's, resulting in extremely significant savings. Troy backed his VBF mandate by linking the annual bonus objectives of law department personnel to contributions to GELRT's progress, and he supported this by regular global broadcasts to the Law Department communicating progress towards the goal. Since its launch, 57 Outside Counsel Selection Initiative events have been completed to date, resulting in total estimated savings of over \$32.6 million when the winning firm's budget is compared to its final VBF offer.

(Source: http://www.acc.com/valuechallenge/valuechamps/2012champ_profile61.cfm, March, 2015)

A clear example of skills in purchasing services is implemented in case study 6.4 where Bob Harchut and Dan Troy showcase some of the skills as mentioned in table 6.2 Troy showed that the hourly-rate billing promoted inefficiency and he changed payments to a value-based fee (VBF). This is an example of the 'product features' competence and the 'ability to measure effectiveness' competence. Consequently, Harchut assembled a cross-functional team to develop tools and processes. This is a clear example of the 'relationship' competence because different capable employees from different departments were selected for the job. Moreover, it showcased the 'organizational capability' competence because the cross-functional team was assembled quite efficient. Moreover, Troy linked the annual bonus objectives of law department personnel to contributions to GELRT's progress. This is an illustration of recognizing product

value, or the ‘product value’ competence. Note that *product* refers to the delivered service. This program resulted, overall, in \$32.6 million savings. So, also other firms started implementing this way of working and billing. Eventually, this shows that other service purchasers possess the ‘recommendation’ competence as well. They were able to value the recommendation from business contacts and purchase legal related services more efficiently. Obviously, possessing the required skills to purchase services in one culture is advisable. However, as indicated earlier, most companies have an international aspect where purchasers have to deal with different cultural aspects. Therefore, the global aspect influences the required skills to purchase services as well.

GLOBALIZATION AND ITS IMPACT ON PURCHASING SERVICE SKILLS

When taking the increasing globalization into account it is highly interesting to look at ways to enhance the skills in purchasing services, as well as the general skills in purchasing. In chapter 5, the general skills are compared to cultural differences. It makes sense to compare the required skills to cultural differences. As indicated before that differences exist between general purchasing skills and skills required for purchasing services, it is relevant to know how they can be invigorated in modern globalized business by applying different cultural dimensions. Hofstede’s cultural dimensions (Hofstede, 1980, 1999) are the right tools to compare the skills. Even though there is a gap in literature regarding specific skills required for purchasing services in a heavily globalized world, some research conceptualized cultural differences. The majority of these researches used Hofstede’s dimensions as culture-related conceptualization (Pemer et al., 2014). Unfortunately, there is not much existing research on this topic yet. The evaluation in this paper is based on the cultural differences among all dimensions based on personal knowledge. Hofstede’s dimensions among all countries can be found at www.geert-hofstede.com/dimensions.html (status: march 2015).

Product features

The dimension that have influence on the product feature competence would be the ‘*Masculinity versus Femininity*’ dimension. When a society is more inclined to masculinity, short-term achievement, heroism, assertiveness and material rewards. This affects product features in such a way that purchasers are more inclined to purchase services that deems most success for them personally, especially in the short term. However, this might collide with the (internal) client’s long-term needs. For instance, a purchaser might buy the cheapest law-firm service, which is beneficial in the short-term. However, in the long-term this cheap law service might result in bad advice that leads to significant losses for the company as a whole.

Reputation

The dimensions that influence the reputation competence would be the ‘*Power Distance Index*’ dimension. This dimensions indicated the degree to which less powerful members of a society accept and expect that power is distributed unequally. Hence, purchasers might not be able to objectively identify the reputation of the service provider because they heavily look up to this service provider.

Expertise

Here, the same dimensions and argumentation accounts as with reputation. A purchaser might have a blurred view of the service provider’s expertise on account of the service provider’s reputation.

References

In individualistic cultures there tends to be a loosely knit social framework in which individuals mostly try to take care of themselves instead of consulting others. Hence, purchasers are most likely less sensitive for references given by business contacts through Word-of-Mouth.

Recommendation

The '*Individualism versus Collectivism*' dimension also is relevant for the competence of evaluating recommendations from professional and non-professional contacts as purchasers in individualistic cultures will most probably try to evaluate delivered services themselves.

CONCLUSION

Purchasing services influence organization's functioning, therefore poor purchasing decisions can result in poor performance (Mitchell, 1994; Van der Valk & Rozemeijer, 2009; Soriano, 2001). To reach good performance it is essential to conduct service purchase process very firmly and carefully. Focus only on cost reduction may decrease reputation, service provider's profitability and even the received services may suffer due to a lack of motivation. By following a certain guideline it might easier to improve purchasing quality.

- To buy services as part of the company's value proposition, it is advisable to create cross-functional sourcing teams in which internal customer are in the lead and procurement has a facilitating role
- Suppliers have to be qualified by using input, throughput criteria, and critical supplier capabilities
- The contract should be focused on output and outcome criteria
- Supplier's expected performance should be the main award criterion.

By playing to the new service related rules, the interests of internal and external customers can be retained. A close collaboration and team play between the different sides is precondition. Lower organizational costs and better value contribution to the company's customers are the main results. So to speak: a win-win-situation.

FUTURE SECTION

As was stated by multiple authors, the field of service purchasing needs to be explored more. Mostly all service research projects are conceptually developed and lack empirical validation. Van der Valk and Rozemeijer (2009) recommend *'action research'*, where researcher can intervene in actual purchasing processes to see directly if there is an impact on customer satisfaction. Fitzsimmons et al. (1998) argued that decision-making process for services could be very different for which service that planned to be bought. So a closer look on different types of services is appropriate. Furthermore, future research should be adjusted to measure different categories of services by the help of identifying characteristics, which set services together (Smeltzer & Ogden, 2002; Lovelock, 1983). Driven by globalization, there has been an increasing relevance of outsourcing services. They affect every industry branch and contain services like information and communications technology, cleaning, consulting, accounting or even security. Growth does not mean that the capability of handling the situation has been grown as well. A rethinking process has to be implemented by the organization and especially by the purchasing department. Moving away from traditional purchasing process should lead to *"integrate the steps of pre-selecting suppliers and detailing the initial specification in close collaboration with these suppliers. In this way, both parties can jointly make an effort to maximize the value for the buying company, and, as such, also for the service provider"* (Van der Valk and Rozemeijer, 2009, p.8).

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Chapter 7

SUSTAINABILITY

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Abstract:

Since the mid-20th century, the level of greenhouse gases in the atmosphere due to over-industrialization keeps increasing. Thanks to the researches made in this field, sustainable development and all the issues it implicates are nowadays well assimilated worldwide and in every field. The level of sustainability is likely to be measured by scientists and economists. Plus, the external pressures on companies (public interest, NGOs, governments) forces them to adopt green behaviors. Regarding the purchasing function, senior managers start understanding the strategic role of purchasing and its impacts on the companies' outcomes. Thus, the purchasing function is more and more integrated within the corporate strategy. As it deals with a large part of the supply chain, from the suppliers to the final customers, it is furthermore obvious to integrate sustainable issues on the purchasing role. In this chapter, the authors stress the new importance of sustainability within purchasing. A literature review and case studies will help the readers to better understand this issue and all its implications. Some considerations about how to deal sustainability within the purchasing field will also be covered.

Key words:

- **Sustainability**
- **Triple Bottom line**
- **Sustainable purchasing**
- **Corporate social responsibility**
- **Ethical sourcing**
- **Code of conduct**
- **Sustainable sourcing**
- **Green purchasing**
- **Life cycle assessment**

INTRODUCTION

During the industrial revolution (1830-1840) a new breed of men was born, industrialists like *John. D. Rockefeller* (oil) and *Andrew Carnegie* (steel) started to scavenge the earth for precious resources. Furthermore, during the turn of the 19th century, visionary men like *Henry Ford* (automotive) invented mass production. These radical changes and new inventions gave way for a new business function, purchasing became a key role within any organization striving to outperform its competition. However, this urge to become cost effective and provide goods for the masses resulted in a neglect in environmental and social aspects. Some researchers argue that the purchasing function can be seen as one of the main contributors to climate change (Salam, 2011). Therefore, it is important for organizations to be aware of the sustainable purchasing approach that will be further explained in this chapter. This approach takes the impact of the strategic purchasing function on the environment into consideration. The first part of the chapter will enhance the definition and principles of sustainability. It does so through analyzing the *triple bottom line* and linking these principles to the strategic purchasing function. The next part will enhance ethical sourcing and corporate social responsibility, by analyzing the code of conduct and the impact of purchasing on an organization's reputation. This is followed by the implication of sustainable purchasing and the chapter ends with current and future trends in terms regarding sustainability within the strategic purchasing function.

Definition and Principles of Sustainability

This chapter will start by introducing the reader to sustainability as a movement that emerged around 1950, became considered at a global scale in the early 1990's and has risen awareness since the early 2000's. The main points of sustainability will be discussed first, to be followed by linking sustainability to purchasing.

Sustainability and the triple bottom line

In 1968, the notion of Sustainable Development emerges for the first time from the first *Club of Rome's* meeting. This think tank regroups scientists, intellectuals, economists and deals with many environmental and political issues since its formation. Considered as a precursor regarding the sustainable development issues, it financed the *Meadows report* (Meadows, Meadows, Randers, & Behrens III, 1972) which presents several scenarios for global sustainability according to the World3 computer model. This model developed by the Club of Rome takes into account five variables: world population, industrialization, pollution, food production and resources depletion. By using it and altering the different variables, the researchers simulate future expectations. The Meadows report has been mainly reviewed by the scientific field, which considers that economic growth will end by itself and humans cannot intervene. It has been updated twice by its own authors (1997 and 2012), considering the changes occurred and the critics from scientists, economists and public personalities. However, the official definition of sustainable development is likely to be the one recognized by the 1987

report of the International Commission on Environment and Development (*Brundtland report*):

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs." (Brundtland report, 1987, p. 41)

This means that current generations need to create rules and regulations in order to manage their impacts on the environment as to give future generations the possibility to also use the planet (in a sustainable matter). However, a framework is needed in order to implement rules. Sustainable development needs to have boundaries and be more explicit on its exact definitions. In this regard, John Elkington introduced the term *triple bottom line* (TBL) in 1994, a framework that includes: environmental, economic and social issues. As Weiss (2009) states, "the TBL approach is intended to help companies integrate the three components of sustainable development into their core operations and to translate sustainability theory into management practice" (Weiss, 2009, p. 325).

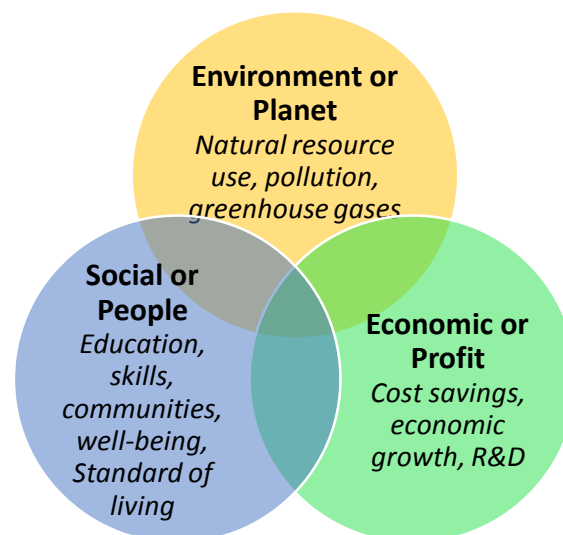


Figure 7.1: The Triple Bottom Line

Figure 7.1 represents the relationships between the three issues concerning sustainable development. According to Andrew Savitz (2006), in Slaper and Hall (2011, p. 4), the TBL "captures the essence of sustainability by measuring the impact of an organization's activities on the world... including both its profitability and shareholder values and its social, human and environmental capital". Thus, the TBL is also called the three P's: people, planet and profit. But according to Slaper & Hall (2011), the hard part is not to define what the TBL is, but to measure it. The Sustainability Society Foundation has set up the Sustainability Society Index in order to compare the level of sustainability between different countries and to determine how these evolve. This index takes into account the three elements of the TBL, which will be enhanced accordingly over the following pages.

Environmental issues

The 1992 SustainAbility Limited report in Elkington (1994) stresses that more and more industries are part of the environmentalists' scope over the years. Indeed, while only five industries were targeted in the 1960s, there were 54 in the 1990s. The *Kyoto protocol* (1997), considered as an extension of the 1992 Rio's Earth summit, recognized that industrialized countries are mainly responsible for the high level of greenhouse gases in the atmosphere. A total of 192 parties pledged to reduce their CO₂ emissions for 2012 and hence, their environmental footprint. It is the responsibility of all the countries involved in the process to make companies respect the regulations set by the summits. Governments and companies alike work together to reduce the global ecologic footprint. Therefore, companies have to establish both internal and external rules to manage their eco-friendly level. The internal rules are mostly at a low level (not printing emails anymore, using recycling paper instead of regular one, etc.) whereas the external ones are at a higher level (managing the ethical sourcing). In the same way, we can differentiate the local and global levels. Companies implement local rules as taking care of the area around them to be clean, but also global rules as traveling less by using new ways of communication (videoconference for instance).

Economic issues

Industries are the first guilty parties regarding the high level of greenhouse gases. Thus, the main challenge is to find a balance between protecting the environment and developing the activities. The United Nations Environment Programme (UNEP) defines on its website the green economy "*as one that results in improved human well-being and social equity, while significantly reducing environmental risks and ecological scarcities.*" Green economy therefore includes the two other aspects of the TBL. As Khor (2012) states in his article for the UN Conference on sustainable development, international policies should support national policies concerning green economic actions. He also adds that "the green economy should thus be defined and operationalized in this EDE (environment, development, equity) framework, which must also incorporate both the national and international dimensions" (Khor, 2012, p. 72). Then, the economic issue needs to be considered at a national level but mainly at an international level. The cooperation between developed and developing countries is a success key to manage efficiently the green economy aspect. It is mainly agreed that the only responsibility of a firm is to make profits. Since the companies' environment has changed, they now have to think about how to make profit in a green way, taking into consideration all the TBL aspects.

Social issues

The social part of sustainability mostly deals with the caring of each other's welfare (Torjman, 2000). Regarding TBL, companies have to satisfy all the corporate, employees and stakeholders' needs. This element of the TBL is strongly linked to the corporate social responsibility (CSR) of a company. CSR has been set up in the 1950's, and has increased over years, showing its relative importance within companies (Carroll, 1991). Moreover, CSR is linked with companies' ethical code of conduct, regarding their relationship with the suppliers and the customers (Preuss, 2009). According to Kaptein (2004), the code of conduct is a formal written document that establishes responsibilities of the firm towards their employees and stakeholders. Nevertheless, the growing awareness about ethical sourcing practices forces companies to re-examine their ethical sourcing policies. It was the case for Nike and Tesco

during the past decades, which have outsourced their production in Mexico and Bangladesh, where the labor markets are unregulated (Hindle, 2008).

TBL's measurement

The TBL is a way to measure the level of sustainability regarding the three P's. However, it can be tricky to measure the profit aspect in the same way as the planet and people impacts. Indeed, profit is mostly measured in dollars whereas the two other parts of TBL cannot be dollar-based. Slaper and Hall (2011) propose an index to measure the environmental aspects, as an international accounting method already exist. Nevertheless, even with an index there is a large part of subjectivity: *“how are the index components weighted? Would each “P” get equal weighting? What about the sub-components within each “P”? Do they each get equal weighting? Is the people category more important than the planet? Who decides?”* (Slaper & Hall, 2011, p.4). Thus, TBL should be further investigated before it can be used as a descriptive tool for environmental analysis of organizations.

RELATIONSHIP SUSTAINABILITY AND THE STRATEGIC PURCHASING FUNCTION

According to Closs, Spier and Meachman (2011) sustainability becomes a significant pillar in corporate objectives. Moreover, with the beginning of the 1990s, there has been raising pressure on organizations particularly in terms of environmental consequences that are caused by end products or processes of companies (Kleindorfer, Singhal, & Van Wassenhove, 2005). However, for instance Porter and van der Linde (1995) argue at the same time that concentrating on sustainable actions may lead to an increased firm performance and to competitive advantage on the market. In the 21st century, several authors such as Kaiser, Eagan and Shaner (2001) and Zhu and Geng (2001), (as cited in Giunipero, Hooker, & Denslow, 2012) investigate the issues of sustainability more thoroughly by focusing for example on the product life cycle in the material selection process or the influence of green purchasing on a corporations' choice of suppliers. Krause, Vachon and Klassen (2009) further mention that a firm is only as sustainable as their suppliers from where it purchases the materials. In addition to that, Meehan and Bryde (2011) identify internal and external key drivers of sustainability that may influence the purchasing behavior of companies. Internal drivers are for example the need for managing change as well as adjustments to the organizational structure (Siebenhüner & Arnold, 2007). This can be referred to the internal alignment of purchasing into the corporate strategies, as some companies set their mission and value statements according to sustainability standards. In contrast, external drivers are represented by fast changing customer needs, increased regulations concerning the environment by the International Organization for Standardization (ISO) as well as additional pressures by the government and stakeholders (Sroufe, 2003). Out of this reason, Rondinelli and Vastag (1996) (as cited in Giunipero et al., 2012) have stated that companies need to constantly adapt their sustainability policies for their production plants and for their criteria in the supplier selection processes. As we can see on figure 7.2, companies need to find the right balance between internal and external drivers in order to manage their sustainability.

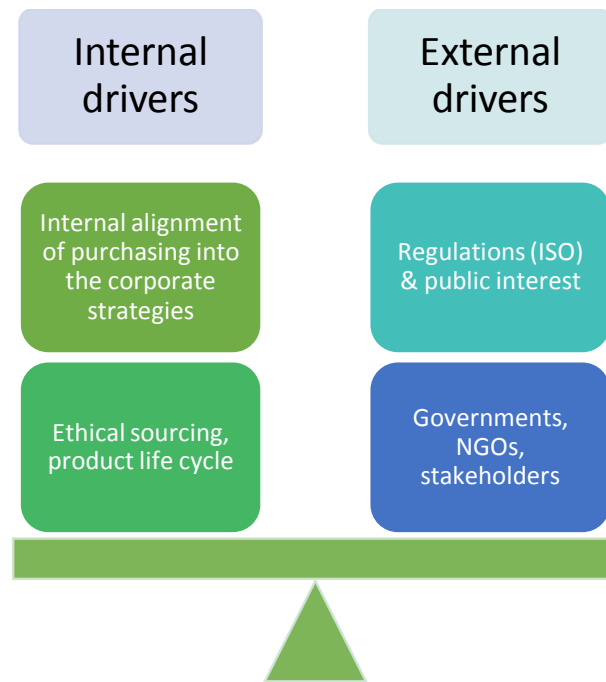


Figure 7.2: Sustainable purchasing balance

Sustainable procurement, also known as “green” procurement, is according to Walker and Brammer (2009, p. 128) defined as “*procurement that is consistent with the principles of sustainable development, such as ensuring a strong, healthy and just society, living with environmental limits, and promoting good governance.*” Due to this fact and the shifts that result from globalization, an increased amount of companies includes green procurement practices in their corporate strategies, like for example Samsung which has implemented green supplier incentives to improve the capabilities of their worldwide supplier network (Blome, Hollos, & Paulraj, 2014). However, to be able to implement sustainable procurement, the pillars of the triple-bottom line by Elkington (1998) in Crespin-Mazet and Dontenwill (2012) need to be taken into consideration. As mentioned previously these are people, profit and planet. Carter and Rogers (2008) (as cited in Crespin-Mazet & Dontenwill, 2012) argue that people refer to cultural issues and human rights, profit deals with the economic performance of the firm and planet considers the protection of natural resources and waste reduction. Then, codes of conduct are used to implement boundaries and rules regarding the relationships implemented with suppliers. Pater and van Gils (2003) mention that the code of conduct promotes and assists organizations in dealing with ethical behavior, which is of a particular interest for the strategic purchasing department that want to source from suppliers that work consistent and in line with these sustainable requirements. The principles of code of conducts and its role within CSR will be discuss in the following part.

ETHICAL SOURCING AND CORPORATE SOCIAL RESPONSIBILITY

Eells and Walton (1961) (as cited in Carroll, 1991, p. 39) define corporate social responsibility as “*the problems that arise when corporate enterprise casts its shadow on the social scene, and the ethical principles that ought to govern the relationship between the corporation and the society*”. Nowadays, companies face external pressures from public interest, NGOs and governments. With the globalization, the number of potential suppliers’ increases and external drivers are focused on their level of ethical responsibility. As the environmental impact of a company relates to its supply base (Tate, Ellram & Doolay, 2012), public interest often focuses on how suppliers manage their social policies (Roberts, 2003). For this reason, companies have to manage their ethical sourcing and carefully choose their suppliers. After some considerations about CSR and its role on purchasing, implementation of the code of conduct will be elaborated. Then, the relationships companies have to implement with their suppliers and the evolution of portfolio models in the case of environmental purchasing will be considered. Finally, some considerations about sustainable sourcing and its impact on companies’ reputation will end this chapter.

The effect and role of CSR on purchasing

CSR in general is nowadays a broadly used term including; corporate citizenship, business ethics, management of stakeholders and sustainability (Carroll & Shabana, 2010). However, Friedman (1970) (as cited in Crane & Matten, 2010) argues that the only responsibility of a firm is to make profits. Nevertheless, literature suggests to include social and environmental practices to achieve sustained competitive advantage (Carroll & Shabana, 2010). Generally, social objectives of an organization are unemployment reduction as well as the management of health and safety issues for their employees (Carroll & Shabana, 2010). For strategic purchasing, this could mean to engage in long-term relationships with the suppliers and help them during economic downturns to secure employment. In addition, environmental goals contain the reduction of waste, the minimization of water usage, decrease of CO2 emissions and the use of alternative energy sources, such as solar and wind (Hoejmose & Adrien-Kirby, 2012). Moreover, an environmental goal for the purchasing department could be to purchase products that can be recycled, are energy-efficient and not harmful to the environment.

Nonetheless, according to Millington (2008) socially and environmentally responsible purchasing (SERP) has been developed only in the late 1990s and currently it is increasingly implemented in the companies’ strategic business objectives. This can be supported by Nalebuff and Brandenburger (1996) (as cited in Keating, Quazi, Kriz, & Coltman, 2008) who argue that organizations recognize the importance of collaborative working together with the partners in the supply chain to enhance the firm’s CSR performance. However, similar issues identified by (Pitman & Sanford, 1994) such as corruption or bribery have been addressed earlier and have been the starting point for CSR. External drivers for SERP include customers, governments, non-governmental organizations (NGO’s) and investors. Internal drivers include stakeholders and top management leadership (Hoejmose & Adrien-Kirby, 2012). Keating et al.

(2008) also identified the top management leadership and the firm's people-oriented culture as key drivers for a socially responsible purchasing.

One important issue that needs to be addressed is how to ensure and extent the CSR practices in the relationships between buyers and suppliers. As it will be mentioned later, the code of conduct is one possibility, as it is an important source of competitive advantage (Hoejmosse & Adrien-Kirby, 2012). However, Boyd, Spekman, Kamauff and Werhane (2007) recommend to add the procedural justice approach to the code of conduct to be able to ensure good SERP practices that are built on trust, collaboration and communication. According to Crane and Matten (2010, p. 400) procedural justice is defined as *“the fairness of the processes through which decisions are made.”*

The advantages of the purchasing department to engage in CSR practices are the long-term self-interest of the organization, as proactive behavior is better opposed to reacting behavior (Keating et al., 2008). Keating et al. (2008) further state that customers and the public in general strongly appreciates CSR practices, therefore promoting its implementation. This is also the case for large coffee companies such as Starbucks or Nestlé. These corporations have promoted the procuring of Fair Trade coffee. Fair Trade guarantees a minimum selling prices of coffee that are above market standards, as well as minimum social, labor and environmental standards (Jeffrey, 2012). As a consequence, Ethiopian farmers have higher earnings which provide them with regular food and accommodation (Jeffrey, 2012). However, other examples exist where CSR practices have not been successfully implemented, although they have been promoted to the public. One of these examples is from NIKE in 2011, where factory workers in Indonesia have complained about unfair working conditions, with physical and mental mistreatments (DailyMail, 2011). The company has been forced to investigate this matter to re-improve their image and comfort the society and NGOs. Thus, it can be concluded that firms strive for reducing the effects of potential risks through CSR failures by defining standards and rules for their suppliers that need to be met in order to build a relationship and do business together (Keating et al., 2008). Therefore, sustainable purchasing gains significant importance, as the organization is directly affected by social, environmental or legal forces in their supply chain (Keating et al., 2008).

Principles of CSR and links to Ethical sourcing

Carroll (1991) introduces the “Pyramid of CSR” (*figure 7.3*). This model consists of four pillars which are the economic and legal obligations of the corporation as well as the ethical and philanthropic ones (Carroll, 1991). The economic responsibilities on the bottom of the framework describe that the principal task of the firm is to provide goods and services as well as to maximize profits (Carroll, 1991) which might be related to the fact that the company is interested in purchasing at the lowest price. The second level is called, legal responsibilities and deals with the issues that a corporation needs to act in line with regulations introduced by local or federal governments (Carroll, 1991). Having shortly explained the two “basic” ideas of the pyramid of CSR, the third level is concerned with ethical accountabilities. This means that the corporation is expected to consistently perform on the basis of societal expectations and ethical norms which can be explained by the increased attention of the public, who see the

firm as responsible for their employees for example in health and safety issues (Carroll & Shabana, 2010). The top of the pyramid, the philanthropic level, suggests that the firms needs to act beyond the desires of the society, which consequently leads to the fact that the companies engage in incentives or programs that go beyond their corporate strategies (Carroll, 1991).



Figure 7.3: Pyramid of CSR (Carroll, 1991)

Ethical sourcing relates to the Pyramid of CSR as it deals with ensuring that the product is sourced whilst respecting the triple bottom line: safe working environment, limited environmental impact and fair wages. The consumers pay more attention about how, where and when their purchased products are made (Dickson, 1999). Shen (2014, p. 6237) highlights this consumer's pressure by stating that *“previous studies reveal that fashion consumers are interested in purchasing sustainable fashion products and also willing to pay a higher price as long as the quality of eco-product is satisfied”*. Moreover, fulfilling stakeholder's wishes positively impacts an organization's reputation (Fombrun & Shanley, 1990). This external pressure fosters companies to implement ethical sourcing initiatives. The balancing of the risk of inaction versus the benefit of action help companies decide on their ethical sourcing strategy (Roberts, 2003). Therefore, it becomes apparent that strategic purchasing is an important entity in enabling for a sustainable supply of raw materials. One means of improving the purchasing department, as illustrated before, is by implementing a code of conduct.

Codes of Conduct

As the head purchaser from Gasunie (Ad Weterings, 03-05-2015) explained during a guest lecture, international institutions and governments regulate sourcing policies by several legislations. Purchasing departments have to consider the different level of the law: firm law, national law and international law. However, Chen and Lee (2014) stress that *“what makes the ethical sourcing problem challenging is that it is often impractical for the big multinationals to levy a stiff penalty on the small suppliers in emerging economies, except to terminate the business relationship”* (Chen & Lee, 2014, p. 3). Especially in times of globalization, ethical behavior as well as cultural understanding gain significant importance. This consideration

makes supplier selection more complicated. Focal companies have to impose some rules within their supply base to ensure that all their expectations and needs are respected. Hoejmose and Adrien-Kirby (2012), as well as Leire and Mont (2010) mention the code of conduct as a solution to ensure and extent the CSR practices in the relationships between buyers and supplier. The code of conduct therefore, should not solely include rules but also give guidance to employees on behavior, define standards and provide support for the employees in the purchasing department. Schwartz (2001) as well as Carasco and Singh (2003) (as cited in Preuss, 2009) further argue that this code guides employees how to behave and it sets uniform standards that are particularly needed in global companies to ensure the same service and quality standards throughout the organization. Signed by both the company and the supplier, codes of conduct let consumers be sure that their products are made according to ethical processes, respecting the TBL issues.

In its Code of Conduct, the Swedish fashion company H&M Hennes & Mauritz AB specifies *“what we require from our suppliers, their subcontractors and other business partner in order to fulfill our commitment to our board of Directors, to our employees, to our customers, to our shareholders and to other stakeholders. (...) We base our requirements mainly on internationally agreed standards such as the Universal Declaration of Human Rights, The UN Convention on the Rights of the Child and applicable ILO Conventions, as well as national legislation.”* (H&M, 2010, p. 1).

Case Study 7.1: Ethical sourcing level according to the sector

A large part of companies from the branded clothing and footwear sector has integrated ethical sourcing codes in their strategies. The main reason is because they are likely to be a good and easy target for external pressure groups regarding their activities and how they manage them. The public interest is focused on the intermediate supplier and then, the focal company needs to manage its supply base. Because of the lack of interest from governments about the deforestation, NGOs developed the Forest Stewardship Council's (FSC) forest certification to regulate the forest products sector's activities. First hostile to those standards, companies now use them as a reference and an evidence of their ethical sourcing strategy. Indeed, all the firms from the supply base of DIY products' manufacturer (sawmills and forest owners especially) need to be FSC certified. The public interest is now focused on the beginning of the supply chain (primary producer). Companies ask the certification in order to enhance their reputation within stakeholders. But regarding the paper factor, it is a tough task to track all the suppliers and certify them. That is why companies from this sector have not set up ethical sourcing strategy yet. Regarding the branded confectionary sector, big companies (such as Mars, Nestle, and Cadbury) were alleged to use child labor force on cocoa farms. The public interest is one more time focused on the primary producer. However, the raw chocolate come from a lot of different suppliers. It is thereby impossible to set up an ethical sourcing code, tracking all the different suppliers. Finally, some sectors are more likely to establish ethical sourcing codes than others. This depends on the pressure level from external groups (NGOs, public interest, media).

(Roberts, 2003)

Companies from the clothes and footwear sectors are more likely to be criticized and at the center of the attention than other sectors (Case Study 7.1). Thus, they need to provide more evidences of their ethical sourcing strategy.

Case Study 7.2: Impacts of Corporate Code of Conduct on labor standards: Reebok's athletic footwear supplier factory in China

The US-brand Reebok has been developed in 1895 and since the 1980s the company is recognized as one of the top sportswear around the globe. During the 1990s, the implementation of CSR practices that specifically concentrate on the protection of human rights enabled the firm to increase their image on the market. In fact, these practices have been quite successful due to the fact that one of the main competitors, namely NIKE, has been confronted with boycotts and several protests in the 1990s. Instead, Reebok has achieved low media attention during this period of time and consequently it can be stated that the high investments in CSR practices have led to an increased profitability and performance. However, the impact on the social level is rather unclear. To conclude, it has been investigated that due to the introduction of labor-related codes of conduct, a race to the ethical and legal bottom has occurred, as factory workers have been forced to work stronger and more quickly but for lower earnings.

(Yu, 2008)

Shen (2014) details both the different programs launched by the company and the certifications gotten from NGOs. Thereby, H&M launched the “Conscious Action” program which deals with the TBL issues (Shen, 2014); involves the Better Cotton Initiative (BCI) which ensures the provenance of the cotton used; cooperates with the World Wide Fund for Nature (WWF) regarding water issues; is certified for each category of sustainable materials used. Then, implementing a code of conduct and an ethical sourcing strategy impacts the company's reputation. Indeed, external groups pressure the companies to respect the TBL issues by implementing ethical sourcing, and their reputation increases within these groups (Case study 7.2).

Relationship with suppliers and sustainable purchasing portfolio model

After a short literature review about purchasing portfolios, Pagell, Wu & Wasserman (2010) state that companies have to manage their types of purchases according the four item classes mentioned in the portfolio matrix by Kraljic (1983). This induces different relationships with the suppliers. For instance, the leverage items' purchase is based on the price and can be negotiated with different suppliers. Thus, the focal company does not need to concentrate on the relationships with this kind of suppliers. Many authors tried to find other theories about portfolio's model, however most of them are very similar to Kraljic (Gelderman & Van Weele, 2005). Thus, we consider it as a standard. However, it takes into consideration solely two dimensions (2*2 model) and since 1983, the purchasing process has evolved. For instance,

purchasing departments should pay attention to their environmental impact. Although the number of articles concerning EPSM keeps increasing but the lack of practicing does not let researchers introducing innovation theories (Tate et al., 2012).

Case Study 7.3: Pizza restaurants

Pizza restaurants is a local chain with four outlets. Instead of buying its products at the wholesale product markets, Pizza Restaurants choose three small local suppliers. In the long-term contracts signed with each suppliers, the food chain sets a minimum level of demand for a price higher than the market average.

Thus, the local chain sets up a stable common prosperity relationship with its suppliers, and reduces the risks for its suppliers. This is an example of supply-base continuity: the buyer-supplier relationship is not a mere one but the focal company cares about its suppliers and helps them on the risk reduction.

(Pagell et al., 2009)

However, we know that in the case of an ethical sourcing policy, buyer and supplier are both looking for a common prosperity (Pagell et al., 2010). For that, the focal company needs to implement some actions in order to reduce the supplier risk. Indeed, according to Tate et al. (2012), the most efficient action regarding the environmental impact would be to focus on suppliers' initiatives. It could be implemented for instance by reducing the packaging or by using ship transportation instead of non-ecofriendly ways of transport (by plane, trucks, etc.). This common prosperity is the basis of the *supply-base continuity* (Pagell et al., 2009). This means a relationship where all the parties involved on the supply chain should be proactive and useful for the other parts (Case study 7.3). Then, in the case of environmental purchasing, if the supplier companies do not respect the issues mentioned on the TBL (environmental, social and economic ones), the relationship with the focal company cannot be sustainable. In the same way, it seems important to consider the first-tier suppliers as partners, in order to manage the whole supply-base.



Figure 7.4: Sustainable Portfolio Matrix (Pagell et al., 2010)

Pagell et al. (2010) introduce a new purchasing portfolio model regarding the sustainability (figure 7.4). Because of the changes occurring, companies' purchasing departments need to adapt themselves to a new environment. Thus, purchasing portfolio models evolve in the same time. Indeed, while companies focus solely on profit-based supply chains, they now have to consider TBL-based supply chain, where price takes a minor role. The price issues tends to be replaced by the TBL ones. This new model is the result of the research led by Pagell et al. (2010). They "*observed that a number of leaders in sustainable supply chain management (SSCM) were not organizing purchasing portfolios in the manner suggested by Kraljic*" (Pagell et al., 2010, p. 57). Therefore, this new purchasing portfolio is from practice and not theory. In this sustainable purchasing portfolio matrix, the threat to TBL is considered instead of the profit impact risk from the Kraljic (1983) one. Actually, there are small changes compared to the Kraljic (1983) matrix regarding the strategic, bottleneck and non-critical items. The main change is concerning the leveraged items, which is now divided in three categories: true commodity, transitional commodity and strategic commodity. The true commodity are the closest to the Kraljic's leveraged items: the supplier risk is low and suppliers have a high impact on solely one element of the TBL. Then, the differentiation between suppliers for true commodity items is quite low. Regarding the transitional commodity category, the supply risk is higher as well as the threat to the TBL. The relationship with suppliers is hard to manage during a short period, as they are first considered as strategic suppliers. But as the information asymmetry decreases and the shareholders' expectations fulfill, the supply risk decreases. This is a short-term state. The final category is therefore the strategic commodity. As Pagell et al. (2010) state, "*these types of relationships would reflect critical commodities that transcend simple market economics*" (p. 69). But those items have not a long-term competitive advantage as they have noneconomic attributes.

SUPPLIER SELECTION

The purchasing function has originally been evolved around price, which in turn has resulted in organizations neglecting the environment within their procurement strategy (Gadde & Håkansson, 1994). Some argue that global warming, reduction in air quality, pollution of waterways and widespread loss of biodiversity can all be attributed to the organization of the purchasing function (Salam, 2011). In addition, Tate, Ellram & Dooley (2012) argue that the way in which an organization chooses its suppliers is the primary source of a firm's true environmental impact. In this respect, organizations, like Walmart (Case study 7.4) have been requiring suppliers to reveal their environmental impact. However, it should be noted that such initiatives as shown by Walmart do not automatically give an organization a sustainable reputation. This is mainly due to historical facts related to Walmart which are not very ethical and include such actions as forcing their own technologies onto supplier while threatening to disband contracts and outsourcing warehousing activities to cut prices, which let to overall wages in the US dropping to an all-time low (Jamieson, 2012).

Case study 7.4: Walmart

On July 16th of 2009 Walmart has stated that it will require its suppliers to provide information about the environmental impact of their products and divide the data into sustainability ratings. The company asks its suppliers to reply on uniform questions that measure greenhouse gas emissions, solid waste production, water consumption and production ethics. These questions are ranked on a sustainability index, which in turn will create a more transparent supply chain and drive product innovation. This approach is claimed by Walmart to create a new universal retail standard for the 21st century, used by all suppliers, all retailers and in all countries. In order for it to become successful, the company plans to create a consortium of universities that will collaborate with suppliers, retailers, nongovernmental organizations and governments to develop a global database of product lifecycle information, comprising from raw materials to disposal. It further plans to partner with one or more technology companies to create an open-source platform for the index. It is expected that the company's size will push reluctant retail competitors to follow suit.

(Burnham, 2009)

Reputational impact

The twenty-first century customer has become even more aware of sustainability (Galbreth & Ghosh, 2013). It is increasingly demanding information regarding product origin (ingredients) and the working environment. Therefore, it is important for the strategic purchasing function to be familiar with its suppliers. In this regard, the purchaser focuses not only on its direct suppliers but also on its other tiers. However, assessing suppliers has become increasingly complex with the globalization of supply chains (which will be made apparent in the H&M case on the next page). The above mentioned supplier selection and code of conduct can help purchasers to make sustainable decisions regarding their suppliers. However, purchasers also have to trust their instincts (regarding financial health and trustworthiness of suppliers), which will become apparent in the case regarding the European meat industry underneath.

Product Origin

End-users have become increasingly interested in the origin of their product in terms of ingredients and extraction of used materials. This is mainly apparent in wood products (rain forests), chemicals (e.g. water-based paint) and food products (fair-trade, animal welfare and sustainable fishing). The purchasing function plays a significant role within product origin as it contracts the suppliers. Controlling the origin of a product from local suppliers is easier than that of globally sourced products (Giovannucci, Barham, & Pirog, 2010). This is mainly due to communication, distance and differences regarding culture, habits and regulations. Recently, there has been a scandal in the European meat industry regarding the origin of the product (Case study 7.5). Such scandals can greatly harm an organization's reputation and should therefore be mitigated by the purchasing department through sustainable purchasing. In this case the purchasing department had not assessed its supplier properly. The mistake could be

that the firm has fully trusted their supplier and therefore wrongfully promoted its products. Another theory is huge costs savings (price war within supermarkets) that resulted in limiting or discarding quality control of products.

Case Study 7.5: European meat industry

On the 15th of January, news came out that companies had been wrongfully adding horse meat to products. Whilst not harmful for human health, horse meat is considered a taboo food in many countries. The discovery has led to an all-time low in confidence and trust within the meat processing industry. Additionally, the companies directly involved have been experiencing a loss in sales, loss in reputation and in some cases had to file for bankruptcy. These punishments identify the need for sustainable and fair ingredients.

(Morris, 2014)

Working Environment

Another product aspect, closely related to origin, is the environment in which the product is manufactured. Traditionally, products and materials are sourced or purchased locally and therefore adhere to the rules and regulations of the focal organization. However, the globalization of the supply chain has also increased global sourcing and introduced global procurement. Global procurement differs from local procurement in terms of communication, ethics and culture. Furthermore, by procuring items on a global scale organizations often realize large price reductions. However, as in the case with H&M (Case study 7.6) procuring items from foreign countries can often damage an organizations reputation because of the working environment. For instance, employees often work in harsh conditions (long working hours, routine work), child labor is often more common and there is almost no regulations regarding worker's health.

Case Study 7.6: H&M

December 2012 - H&M came under pressure due to links with suppliers from Uzbekistan (3rd tier), whom often use child labour for harvesting cotton. H&M is but one of big brands being targeted for the use of these suppliers and will be targeted by the Anti-Slavery International's cotton campaign. Such headlines are bad for a company's reputation and often result in expensive actions to find more sustainable suppliers.

(Doward, 2012)

Sustainable and Ethical sourcing

The majority of the articles dealing with the sustainable sourcing solely consider either the social aspects or the environmental aspect (Schneider & Wallenburg, 2012). There is a lack of

relationship between the three issues of sustainable development on the ethical sourcing articles. Some authors try to define what sustainable sourcing is, including the three aspects. It is the case of Pagell et al. (2010), which refers to the sustainable sourcing as “*managing all aspects of the upstream component of the supply chain to maximize triple bottom line performance.*” (Pagell et al., 2010, p. 58) In the same way, “*Tate et al. (2010) require sustainable sourcing to ensure the selection of suppliers that (1) provide good economic value at competitive costs, (2) meet high environmental standards, and (3) enforce the focal organization’s social values and standards.*” (Schneider & Wallenburg, 2012, p. 244). As those definitions do not link the three dimensions of sustainable development, Schneider and Wallenburg (2012) consider the “*three dimensional -coordinate system*” as an easier way to measure the sustainable level within a firm. As it is almost impossible for a company to work alike on the three dimensions, several archetypes of sustainable sourcing profiles emerge from their research (figure 7.5). For instance, while environmentalist companies focus on the environmental issues, leaving the two other dimensions aside, a social activist company does not care about both environmental and economic issues, and concentrate its efforts on the social dimension. Finally, because purchasing is getting more and more considered by the corporate management as a strategic function, it need to take into account other variables than solely its relationships with suppliers (Schneider & Wallenburg, 2012). Nevertheless, there is a gap between theories and practices. Kocabasoglu & Suresh (2006) as well as Paulraj et al. (2006) state the increasing important strategic role within corporate management of the purchasing department. As a result of a supplier-focused purchasing, “*it can be assumed that purchasing itself does not make full use of its competencies and opportunities when implementing sustainable sourcing.*” (Schneider & Wallenburg, 2012, p. 252).

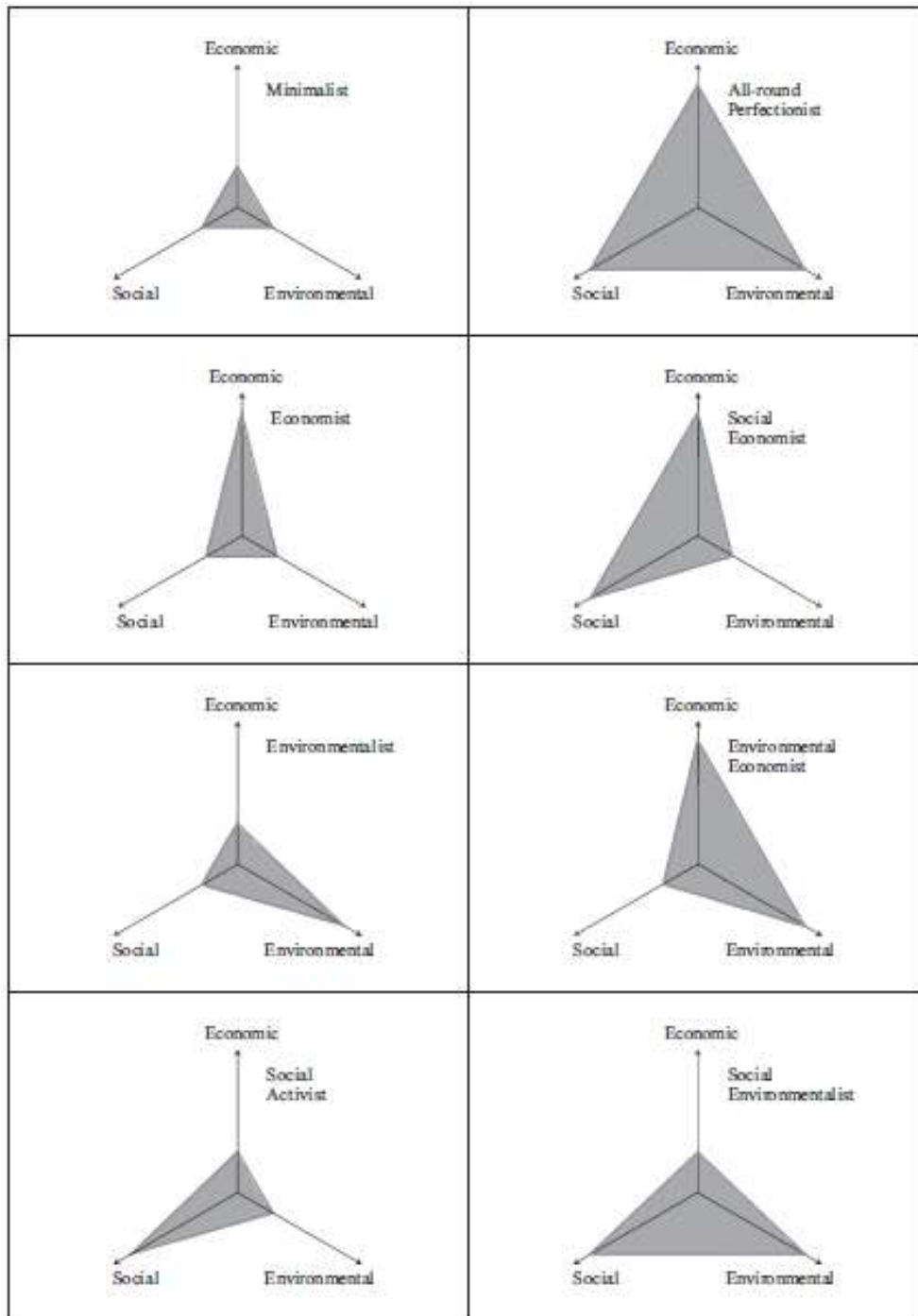


Figure 7.5: Archetypes of sustainable sourcing profiles (Schneider & Wallenburg, 2012)

Nowadays, as companies cope with external pressures, ethical sourcing, by implementing codes of conduct and reducing supplier risks (Case study 7.7), is the right way to deal with these pressures.

Case Study 7.7: Globalization and ethical sourcing

In a globalization context, companies contract new suppliers from emerging economies because of their lower operating and labor costs. However, with the external pressures from governments, NGOs and public interest, companies need to carefully choose their suppliers. The best option would be sourced from certified suppliers. In emerging countries area such as Asia or Latin America, the suppliers often engage unethical activities because of the high cost level of ethical ones. Instead of ending the relationship with unethical suppliers, companies could set up a “delayed payment model contract” with them. Thus, suppliers would be more focus on their own responsibilities, and the focal company mitigate the supplier responsibility risk by this way. Several solution can also reduce supplier risks. For instance, companies can monitor all their suppliers’ activities (e.g. Nike increases monitoring of its supplier factories; Apple increased by 80% its inspection efforts in 2012). Companies can also implement tighter regulatory control (the regulations about labor standards are less strict in developing countries). As education has a positive impact on ethical and social practices, focal companies can provide an education to its suppliers. This education can also relate to the production efficiency (e.g. Nike educates its suppliers about how to better schedule the work and then improve the quality and the efficiency of the production).

(Chen & Lee, 2014)

IMPLICATIONS SUSTAINABLE PURCHASING

This section of the chapter will evolve around the purchasing function and its connection to sustainability. It shows ways in which organizations can measure the environmental impact of the strategic purchasing function and by proposing mitigation strategies to limit said impact. The chapter relates to the previous sub-chapter and guides through several approaches to improve the organizational reputation in relation to sustainability.

Environmental impact

One issue of trying to limit the environmental impact of an organization through the strategic purchasing function has already been discussed in the previous chapter. This means, supplier selection is the first step in assessing the environment and trying to improve the organizations stance in regard to sustainable purchasing. This chapter will elaborate on several other techniques such as the *life cycle assessment* (LCA) approach and *material selection*. The relevance of these approaches has illustrated in the previous chapters as customers are becoming increasingly aware of what they purchase and a growing awareness of climate changes due to the way organizations have been operating.

Life cycle assessment

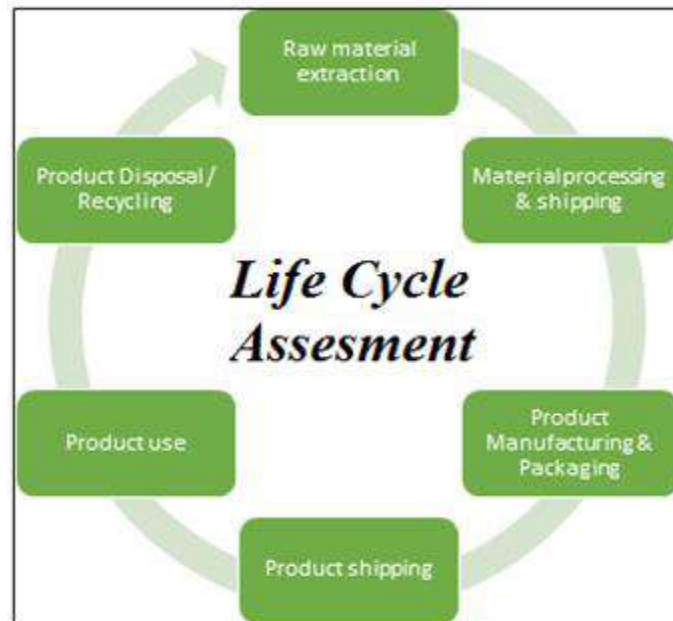


Figure 7.6: Life cycle assessment

The first strategy, life cycle assessment (LCA), considers the impact of a single product on the environment from production until disposal of the product (Jacquemin, Pontalier, & Sablayrolles, 2012). This method was developed in response to an environmental movement to lower the footprint of products on the environment and has been successfully implemented by such multinationals as Unilever. LCA does not directly benefit the focal organization rather than its surroundings (Ortiz, Castells, & Sonnemann, 2009). Furthermore, the method is not limited to stages related to the focal company but also includes stages related to the end-user, as illustrated in *Figure 7.6*. The goal of LCA is comparing all inputs and outputs of a product's material flow and make an assessment of the impact of these flows on the environment. This information will lead to possible improvements to processes, support policies and can provide a base for further product development (Jacquemin et al., 2012). In addition, LCA can be used for new product development, existing product assessment and processes improvement and/or development (Zhou, Yin, & Hu, 2009). Furthermore, it has been shown by Buxel, Esenduran & Griffin (2015) that implementing LCA will greatly improve the company's performance in regard to its competition. However, there are also downsides to LCA. For one, the LCA method requires an extensive amount of data inventory and it mainly quantifies the environmental impact of the product rather than take into account other sustainability aspects such as social - and economic impact and technical requirements (Mayyas, Qattawi, Omar, & Shan, 2012).

Material selection

Traditionally, material selection only considers the mechanical properties, process properties and costs of the materials (Zhou et al., 2009). However, by adding properties of LCA the approach can help organizations decrease their environmental impact. Consequently, material selection becomes a more thorough approach than LCA as it also takes into account economic impact and technical requirements. Furthermore, upon analyzing process properties

organizations are able to include sustainable aspects as energy consumption, pollution, reuse or breakdown of products and recycling.

LIMITATIONS

The previous paragraph has focused on the positive effects of sustainable purchasing on an organization's performance. However, there are also some limits to adopting a sustainable purchasing approach. Sustainable purchasing and its implementation require quite a big effort from the focal organization in terms of time and money. In addition, implementing the approaches as discussed in the previous sections of this chapter is not a guarantee that sustainable purchasing will benefit the focal organization. Thus, there should be clear rules and regulations regarding the adoption and implementation of sustainable purchasing (contract clauses to manage the suppliers, and life cycle assessment to ensure sustainability of the product). In addition, the focal company is to mitigate all possible barriers between departments as the implementation of sustainable purchasing is limited when there is no communication or collaboration between departments. Furthermore, sustainable purchasing is currently only applicable for purchasing goods or materials opposed to the procurement of services. In addition, limited research is done in relation to non-profit and governmental sustainable purchasing. Therefore, sustainable purchasing is currently limited to the manufacturing environment putting a strain on its applicability. Concluding, sustainable purchasing is also limited to long-term goals. Therefore, organizations trying to increase their overall performance in the short-term should not apply the sustainable purchasing approach.

CURRENT AND FUTURE TRENDS IN SUSTAINABLE PURCHASING

In this section current trends within sustainable purchasing will be analyzed. An additional emphasis will be put on future expectations and the section will further conclude the chapter with the importance of sustainable purchasing.

Current trends

A recent publication by Walker, Miemczyk, Johnson & Spencer (2012) shows a huge increase in interest for sustainable purchasing since 2010 among scholars and business alike. Furthermore, even though many organization have been affected by the economic crisis, interest has continued to rise. Therefore, sustainable purchasing can be seen as both a method to decrease the impact on the environment and by improving processes and products alike as a means to increase a company's profit. To indicate the current trends within sustainable purchasing the articles have to be ordered according to their subjects. Additionally, the authors have made a distinction between topics regarding environmental/green measures and social measures.

Environment/green measures

This category shows two key subjects that have been gaining the attention of businesses and scholars during those ten years. The first trend relates to both *internal planning & scheduling* and *organizational processes*. This trend is subject to the life cycle assessment as discussed in this chapter. Through analyzing the raw materials, companies try to improve their processes and concurrently decrease their environmental impact. At the same time companies are increasingly interested in the triple bottom line, therefore the firm cannot only focus on the economic gain. This interest in the triple bottom line links closely with the second trend in this category, which relates to *materials, waste and recycling*. The triple bottom line has enabled companies to no longer merely focus on the internal effects of the purchasing function, but has spiked awareness of the external environment. Companies have been given growing attention to the processes ranging from material extraction to disposal/recycling of the products. In following this trend, companies are able to lower costs and their impact on the environment, improve their reputation and strengthen their reputation.

Social measures

Walker et.al. (2012) identify three main trends within this category subject to the sustainable purchasing function. These trends relate to *conflict of interest, social equity in the supply base* and *(non)ethical behavior*. The conflict of interest relates to the H&M case as presented before, in which the company is accused of child labor without it explicitly knowing. The last couple of years an increasing amount of companies is trying to find ways in which to guard themselves from incidents as illustrated in the case. The main methods in doing so are through contract management, supplier selection/relationships and by life cycle assessment. This trend closely relates to social equity in the supply chain, where all members have to work together in limiting the impact on the environment. Research mostly evolves around aligning interest of the members in the supply chain, integrating practices (both process and system wise) and by implementing supplier assessment programs as illustrated in the Walmart case. The final trend is related to (non)ethical behavior, which is the product of deliberately procuring or offering products that are not in line with the current rules and regulations as illustrated in the European meat industry case. Research in this trend revolves around how to ensure ethical behavior from all members within the supply chain and ways in which to punish non-ethical behavior.

CONCLUSION

The chapter's aim has been, through theoretical models and examples from practice, to introduce sustainability to the strategic purchasing function. The globalization of the purchasing function has resulted in an increased interest regarding sustainable purchasing. The definitions and approaches to sustainable purchasing as elaborated in this chapter give a clear impression of the current state of affairs. Improving the purchasing function through sustainability will have effects on the overall performance of the organization. The adoption of sustainable purchasing will provide organizations with long lasting relationships with suppliers, competitive advantages and a good reputation by offering a high quality and sustainable product. Furthermore, by performing life cycle assessment and materials selection, suppliers are often evolved with the early stages of product development. This collaboration will have a positive effect on the innovational capabilities of both the focal organization and its suppliers. In addition, the exponential growth in sustainable purchasing related research indicates the growing interest within the field of strategic purchasing. However, there is still a

big grey area related to the sustainable procurement of services, and purchasing within the private sector. In addition, the chapter has identified the change in customer wishes regarding sustainable procurement. However, research is still lacking in linking individual needs and customer wishes to the sustainable purchasing function.

FUTURE SECTION

Despite sustainability being a relatively new subject within the purchasing function. This chapter has already identified quite a share of approaches which enable for sustainability within the strategic purchasing function. However, there is still quite a few gaps to fill towards a full understanding of benefits and limitations of a sustainable purchasing approach (Hoejmose & Adrien-Kirby, 2012).

Sustainability is highly researched in regard to private manufacturing, it is expected that future research will focus more on the public sector and procurement of services (Zsidisin & Siferd, 2001). In addition, more emphasis is to be put on balancing different trade-offs and the relationships between different aspects of sustainable procurement.

Furthermore, it would be interesting to link the individual values and customer choices to sustainable purchasing (Zsidisin & Siferd, 2001) in order to fully grasp the positive or negative impact of the approach.

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GLOSSARY

Best value procurement - a procurement process where the risk is shifted to the vendors to show value through dominant expertise, knowing that experts minimize both risk and cost, thus providing the best value for the lowest cost (Van de Rijt & Santema, 2012).

Communication – “the formal as well as informal sharing of meaningful and timely information between firms” (Morgan & Hunt, 1994, p. 44).

Contract management - the process of systematically and efficiently managing contract creation to execution and analysis, with the aim of maximizing the operational and financial supplier performance and reduction of risks (van den Hoven, 2013).

Contracting - describes both the process of outsourcing – the search for and appointment of contractors for the provision of goods and services – and the execution of the contractual relations needed to support such activities (Domberger, 1998).

Corporate Social Responsibility (CSR) – “the problems that arise when corporate enterprise casts its shadow on the social scene, and the ethical principles that ought to govern the relationship between the corporation and society” (Carroll, 1991. p. 39).

Category management – “process for managing entire product categories as strategic business units with a focus on delivering consumer value” (Desrochers, Gundlach, & Foer, 2003, p. 201).

Category captain – “in which a supplier, often the category leader, takes on a significant role in the retail management of the category, including the brands of competing suppliers” (Lindblom, Olkkonen, Ollila, & Hyvönen, 2009, p. 1006).

ESI (Early Supplier Involvement) - means of integrating suppliers’ capabilities in the buying firm’s supply chain system and operations (Dowlatsahi, 1999).

Globalization – “the intensification of world-wide social relations which link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice-versa” (Giddens, 1990, p. 64).

Goods-dominant logic - the objectification of services: this is the reduction process of services to the status of simple objects and aims at making services more tangible (Lindberg & Nordin, 2008).

Green economy - economy that results in improved human well-being and social equity, while significantly reducing environmental risks and ecological scarcities. In its simplest expression, a green economy can be thought of as one which is low carbon, resource efficient and socially inclusive (UNEP).

Institutionalization – “refers to the fact that processes become routinized and systematized over time” (Johnsen, Howard, & Miemczyk, 2014, p. 109).

Internal Alignment – “the set of commitments, strategies, policies, systems and behaviors that support integrated customer decision making based on suppliers’ commercial and ethical commitment and performance” (Sisco & Wong, 2008, p. 5).

Life cycle assessment - a method that is used to account for the environmental impacts associated with a product or a service from inception to end-of-life or cradle-to-grave (Pennington, Potting, Finnveden, Lindeijer, Jolliet, & Rydberg, 2004).

Lead supplier – “the supplier to the category that has the most influence (relative to other suppliers) over the retailer’s CM decisions and actions” (Gooner, Morgan, & Perreault, 2011, p. 18).

Maverick Buying – “the non-compliant, off-contract buying of goods and services, for which an established procurement process is in place based on pre-negotiated contract with selected partners” (Karjalainen & van Raaij, 2011, p. 185).

Organizational learning – “the acquisition of new knowledge by actors who are able and willing to apply that knowledge in making decisions or influencing others in the organization” (Miller, 1996, p. 486).

Outsourcing - use of outside agency to manage a function formally carried out inside the company (Bénaud & Bordeianu, 1998).

Overembeddedness - this process of sticking to the same suppliers, because the buyer-company has built up a good relationship with them (Uzzi, 1997).

Procedural justice – “the fairness of the processes through which decisions are made” (Crane & Matten, 2010, p. 400).

Portfolio model – “a tool that combines two or more dimensions into a set of heterogeneous categories for which different (strategic) recommendations are provided” (Gelderman & Semeijn, 2006, p. 210).

Relationship marketing – “all marketing activities directed toward establishing, developing, and maintaining successful relational exchanges” (Morgan & Hunt, 1994, p. 34).

Service-dominant logic - the view that states that everything is centered on the exchange of services and that the focus has to be on the exchange of intangible resources instead of goods (Lindberg & Nordin, 2008).

Servitization - the increased offering of fuller market packages or ‘bundles’ of customer focused combinations of goods, services, support, self-service and knowledge in order to add value to core corporate offerings (Dachs, Biege, Borowiecki, Lay, Jäger & Schartinger, 2014).

Strategic purchasing – “the process of planning, implementing, evaluating and controlling strategic and operating purchasing decisions for directing all activities of the purchasing function toward opportunities consistent with the firm’s capabilities to achieve long term goals” (Carr, 1997, p. 201).

Sourcing - the part of the purchasing process that aims at selecting and managing suppliers aligned with strategic organizational goals and objectives (Van Weele, 2010)

Supplier integrative capability (SIC) – “a dynamic capability that contains processes to achieve effective and efficient product and information flows between buyers and suppliers, as well as the ability to adapt these processes to environmental change” (Vanpoucke, Vereecke, & Wetzels, 2014, p. 447).

Supplier development – “any effort of a buying firm to increase the performance and capabilities of the supplier, which in turn will improve the buyer performance” (Krause, 1997, p. 12).

Supplier involvement – “the resources (capabilities, investments, information, knowledge, ideas) that suppliers provide, the tasks they carry out and the responsibilities they assume regarding the development of a part, process or service for the benefit of a buyer’s current or future product development projects” (Echtelt, Wynstra, Weele, & Duysters 2008, p. 182).

Supplier relationship management – “the process of engaging in activities of setting up, developing, stabilizing and dissolving relationships with in-suppliers as well as the observation of out-suppliers to create and enhance value within relationships” (Moeller, Fassnacht, & Klose, 2006, p. 73).

Supply base – “the part of supply network which is actively managed and controlled by the buying company. In other words the management and control of suppliers” (Choi & Krause, 2006, p. 636).

Supply networks – “supply networks are nested within wider inter-organization networks and consist of interconnected entities whose primary purpose is the procurement, use, and transformation of resources to provide packages of goods and services” (Harland, Lamming, Zheng, & Johnsen, 2001, p. 22)

Sustainable procurement – “procurement that is consistent with the principles of sustainable development, such as ensuring a strong, healthy and just society, living with environmental limits, and promoting good governance” (Walker and Brammer, 2009, p. 128).

Sustainable development – “sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts: -the concept of 'needs', in particular the essential needs of the world's poor, to which overriding priority should be given; and -the idea of limitations imposed by the state of technology and social organization on the environment's ability to meet present and future needs” (Brutland report, 1987, p.41)

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