

Modern Procurement: Strategic Role and Competitive Advantage

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Abstract. Procurement plays a strategic role in the landscape of the modern business. Globalisation, broadening product range, altering customer demands and economic pressure require to bridge poliformic interests of external and internal business needs by revising approach to value chain concept and accepting the consolidating power of procurement with respect to the modern business organisation. Today, purchasing-supply process has become a value-contributing integral process. It is capable of affecting both top and bottom line and is closely related to the technological solutions that enable to effectively deal with risk and information management issues, optimize end-to costs in value co-creation process.

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Introduction

Procurement is a common business related function to acquire goods, services, equipment, raw materials from various suppliers. Since ancient times purchasing was an expression of demand-supply relationships which developed reflecting various changes that happened in societies' life and needs. For long time procurement was positioned as an operational-administrative business function.

The approach towards procurement started to change around 1990's when various economic models entered attempting to define the role of procurement in the industrial competitive environment and what key driving forces and processes are behind it. By that time Michael Porter in his book "Competitive Advantage", had presented the concept of value chain, procurement or purchasing allocated to the category of the support activities [1].

The landscape of business has greatly changed over the recent 20-25 years. A spurt of technological progress, business globalization and innovations, changes in business models responding to continuously altering market demands, new attitudes to social and environmental issues and a range of other factors had a significant influence on procurement function within organizations. Today, procurement plays far more strategic role as it used to a few decades ago [2-3] because of diverse factors.

This paper aims to outline the main driving forces that evidently transformed procurement from transactional function

to the process and have encouraged its involvement in value creation process in alignment to business strategic objectives.

1. Evolution of Procurement

It is recognized that "professional purchasing addresses five rights: purchase of the right item or service, in the right quality, in the right quantity, at the right price, at the right time" [4]. The Chartered Institute of Purchasing and Supply (CIPS) emphasizes that today "procurement describes all those processes concerned with developing and implementing strategies to manage an organisation's spend portfolio in such a way as to contribute to the organization's overall goals and to maximize the value released and/or minimize the total cost of ownership" [5]. In fact, today procurement is not all the same in different organizations. Maturity of procurement highly depends on business sector, the organization's size and age of organization, as well as level of integrity of business functions and their alignment to business mission [6]. The existing diversity of procurement practices in different organizations can partly be explained through evolution of procurement function in different time stages.

Purchasing and supply as an indivisible sub-system of business, received theoretical assessment only by the end of the 19th and beginning of 20th centuries. Until the WWII, procurement practices were mainly driven by needs of manufacturing companies to contract raw materials. The Second World War slightly changed approach to the procurement, as

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it became the main channel to access reliable sources of supply. However, afterwards a long time purchasing remained a part of administrative-logistic process linked to the central business functions. New practices in procurement gradually took place along with the business growth at national and international levels what fostered interest in collecting and analysing of purchasing related information to be used for more informed decision-making. In late 70's and 80's procurement started to get a wider recognition as an important determinant in value added process [7].

A turning point in history of procurement was the time of 1990's, when procurement received a wider recognition as an opportunity having more meaning for business to cope with challenges of the global market and procurement's role started to be realized as important force in industrial competitive environment and value generation process. Michael Porter in his book "Competitive Advantage" written in 1985 presented his concept of competitive advantage highlighting that 'competitive advantage grows fundamentally out of the value a firm is able to create for its buyers that exceeds the firm's cost of creating it' [1, p.3]. By distinguishing primary and supportive activities in the value chain, Porter allocated procurement or purchasing to the support activities.

2. Historic procurement role

A passive role of procurement assigned by Porter was argued by scholars and practitioners. In modern business environment procurement is deemed a complex interface that actively participates in value creation process in terms of both companies and stakeholders. Modern procurement steps far away from traditional cost-cutting practices [8]. "The reality is that decisions are no longer based entirely on an understanding of direct purchase costs or on easily observable transaction costs, such as transport costs and import duties, but on many other types of transaction costs as well, including those related to cultural, institutional and political differences" [9, p.77].

There are internal and external factors, "hard" and "soft" forces, objective and subjective aspects that shape and influence organizations' procurement system. The majority of them in one or another way are associated and expressed through price competitiveness, managerial practices referring to demand-supply relationships, or technological advantages and risk management that all together have become essential parts of procurement and are indicators of the changing role of procurement in companies of modern times.

2.1. Procurement role: the price competitiveness perspective

Procurement system has a huge impact on the business bottom line. The Fig. 1 clearly illustrates high purchasing

to sale ratio and points to the immense potential of procurement as cost reduction instrument.

The proper assessment of transaction costs, undoubtedly, is a critical issue for trade and investment decision to ensure profitability and larger purchasing volumes [9]. However, "cost and lead time optimization quickly reaches a ceiling" [11, p.862], and thus contributing to bottom line demands appraisal of other opportunities that can bring financial benefits that extend beyond the initial purchase price ultimately gained through hard negotiations [12].

Effective cost management today is established on "coordinating all the different pieces of this chain as quickly as possible without losing any of the quality or customer satisfaction, while still keeping costs down" [13, p.702]. Transactional cost advantages can be achieved differently: through reduction of direct material costs, net capital and inventories, improved transportation, shipment, standardisation of products, implementation of centralised purchasing model, an intensive employment of global sourcing links, the competitive tendering and others [14].

Today's procurement is also in charge of acquisition cost management. It means that focus is given to all associated costs incurring through the life time of usage and owning a certain product [12], rather than only upfront price.

2.2. Procurement role and changing business environment: the value management perspective

Globalisation of business, broadening product range, increased and continuously altering demands of customers, changing nature of competition, and economic pressure all together force companies to redefine the procurement role.

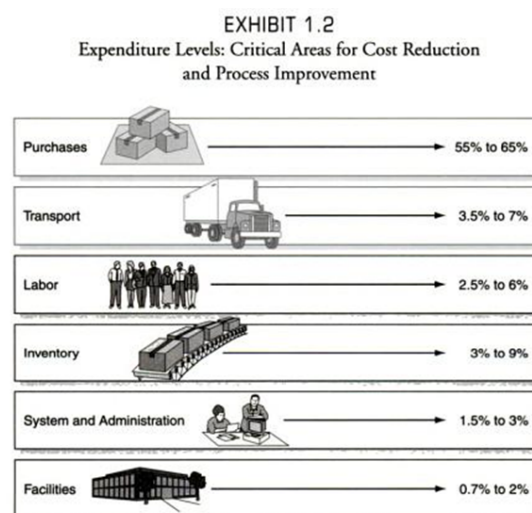


Fig. 1. Expenditure levels: critical areas for cost reduction and process improvement. Adapted according to Ref. [10].

In fact, procurement already has transformed from pure purchasing function to process and it is far more focused on value adding collaborative relations than passive cost procurement [3]. Nowadays, it is deemed as a bridge that links polymorphic interests of external markets with internal business needs [11].

Adoption of value chain concept in practice calls to understand procurement as a consolidating power inside the organization. It has been realised that greater business success can be achieved by giving more attention for long-term strategic benefits that are accessible through knowledge based buyers-suppliers relationship management, combined efforts between various functional divisions and increased focus on business intelligence.

Suppliers' specialization, easy access to new low-cost markets, de-regulation of financial markets, extensive opportunities of global sourcing all together have impact and changed power between buyers and suppliers. Gaining more power, buyers in new era work far more proactively to retain leverage position. It has become common practice when buyers take effort to develop suppliers by involving them in value creation process for new developments and through promoting novel techniques and innovative solutions that, ultimately, lead to optimising lead time, quality at minimised costs. Therefore, to Hartman et al. [15], purchasing-supply process is no longer understood as a clerical function, but rather as a value-contributing integral process capable to affect both top and bottom line.

The changing scope and role of procurement, its extended focus on international markets and opportunities of informed demand-supply management involves new skills and professional knowledge to deal with complex issues in the environment governed by cross-cultural, legislative patterns in effective, rapid and responsible ways. Internal organizational changes arising from redistribution of functions inside companies promote new organizational forms in procurement practice.

For example, cross-functional matrix and projects based teams have become an important source of internal and external expertise to be consolidated for better global sourcing and risk management [16].

The global drive towards sustainability is an additional factor that shapes procurement nowadays. The growing awareness from benefits arising from synergy of ecological, social and economic issues for sustainability of business has become a pivotal orientation for many organizations. In this context, procurement is deemed as an enabler of boosting companies' profits, but also important contributor in growing companies' social capital and reputation. Therefore, sustainability oriented procurement is recognized as an important contributor for alignment of internal and external factors and the enabler of sustainable development of business [17].

2.3. Procurement and information management: technological aspects

Technological progress has become a factor of critical importance that shapes business in the 21st century. Technology is a gate to interact with other organisations. Today's procurement is very much business intelligence and information based process. Information management is deemed as important cost reduction factor. It is acknowledged as an special instrument to gain benefits of strategic meaning. In today's procurement technological capacities have become essential for innovations and partnership relationship management.

Technological solutions allow to organise procurement activities faster, cheaper and in more transparent way for benefits of both buyers and suppliers [18]. For example, technologies allow organise tenders ensuring circulation of relevant information between buyers and suppliers in cost and time saving way. Technology is an important contributor for company's flexibility in terms of purchase volume and purchase mix.

The best expression of companies' procurement process is e-procurement that targets to improve companies' business and financial operations. To Ref. [19], the total value of business to business (B2B) activities was about \$ 7 trillion by 2009, of which North America represented \$ 2.8 trillion, Europe \$ 2.3 trillion and Asia \$ 900 billion. About one third of these transactions were performed electronically [19].

Technology has become an enabler to perform various on-demand analyses as, for example spend analysis, sourcing, suppliers scorecard and performance management [8]. A widening scope of analytical work based on technological advancement and related to procurement is a reflection that actively participates in managing, coordinating and supporting strategic business decisions.

3. Procurement role in times of economic downturn and the future

Recession is a challenging time for most businesses and economies to live through. Financial pressure, the (killed down) unsuccessful investment projects put on procurement even more responsibility due to increasing risks because of possible insolvencies of suppliers and growing need to ensure company's purchasing flexibility. Under conditions of economic uncertainty risk management and information management remain core areas [9] to safeguard business strategic interests. Risk management and information management have been successfully exercised through procurement particularly in high maturity companies such as IBM or Nestle. Also, procurement can benefit through buyer-led cross-project management and further development of technology based social networking which is acknowledged as an enabler to gain win-win position for the both buyers and suppliers [11].

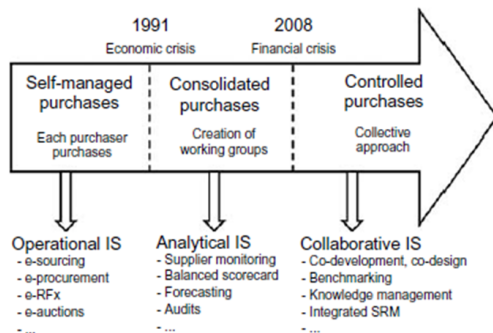


Fig. 2. Evolution of procurement: internal and external collaboration. Adapted according to Ref. [11].

Indeed, to Gattorna and Walters [20] at the stage of economical decline and under the conditions of uncertainty, typically all actors players of the market become high price sensitive, and they can be massively affected unless procurement activities have not been revised. Within this context, the concept of shared value gains a particular meaning. To Porter and Kramer [21], the concept of shared value is an expression of the new approach to competitiveness in the environment of advancing economic and social communities where business operates nowadays. The concept embeds the idea that companies' success today at large depends on their capabilities and capacities to create economic value by taking into consideration a broader social-economic perspective but not just conventional economic needs that usually are expressed by profitability able to present only short-term goals of business entities.

Presenting the concept of shared value, Porter ultimately have acknowledged that societal, economic and technological progress have opened new opportunities and encouraged a package of novel initiatives that should be intelligently assessed and integrated in the new age value practices contributing in variety of forms for shared value creation process [21].

To Rozemeijer et al. [22] the future development of procurement will largely depend on technologically crafted operations responsible for control to access to market and sup-

plier information. Also, it is expected that procurement will be centered on the collaboration of inter-organizational teams responsible for planning and creating the value network to optimize end-to-end costs, value and risks. The ongoing process of re-engineering of procurement is well illustrated in the Figure 2 that reflects evolution of procurement through increasing involvement of more "collaboration internally across hierarchical levels with different business functions, as well as externally with suppliers and customers" [22, p.63].

To summarize what was said above, it becomes obvious that there are many and various studies that clearly illustrate and suggest that today's procurement is based far more on growing interrelationships of various components viewing it either from intra- and -inter-organizational perspective. It leads to value co-creation, the growth of contractual incentives and controlled authority. Collectively all these characteristics obviously point out the radical changes and obvious need to re-position procurement from tactical to strategic level within the framework of any business.

Conclusion

In different time stages procurement has played different roles. Maturity of procurement highly depends on business sector, the size and age organization, as well as level of integrity with other business functions. However, in force of various internal and external factors procurement evidently evolutionised from typical clerical function to value-contributing integral process capable to affect both top and bottom line.

Nowadays, procurement's strategic role is widely emphasized by many authors who point out that in future procurement power is going to increase even more. Rapidly changing business landscape, growing impact of technologies and various constrains related to the economic downturn, as well as the undergoing process of re-orientation of business culture and growing awareness of socio-environmental issues are mentioned among the most important factors that impact procurement system nowadays and will become shaping forces of its development in the nearest future.

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