

STRATEGIC PURCHASING IN A PROJECT- BASED COMPANY – TO CENTRALIZE OR DECENTRALIZE

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Abstract: Organizations all lie on a spectrum, at one end of which are firms with complete centralization of purchasing, and at the other end are firms with complete decentralization. Most firms lie somewhere between the two extremes, and we have already mentioned the most common model that has certain decisions centralized (perhaps strategy design, selection of suppliers, purchasing of major capital equipment, training, co-ordination, communications, etc.) and bulk of purchasing devolved to local buyers. There are many variations on the type of activities that are either centralized or decentralized. In the last 12 years purchasing has noticed two radical changes in the majority of facilities. First change was the reverse of supplier – customer relationships where the role of purchasers changed from persuading and begging the suppliers to ever deliver, preferably with minimum delay (for fixed prices), to standard purchase activities where the purchaser can choose from many suppliers and negotiate prices with vendors to achieve the best conditions for his buyer. The second change was the establishing of a modern IT system that made purchasing activities more effective, more automatic and transparent to a considerable extent. It is good to realize whether all changes have led to improvement or whether these changes have caused a stop or a slowdown of the project purchasing – whether it is possible or even necessary to take into account global as well as local suppliers or to combine them. This Case Study demonstrates how a project - managed organization could look like, where it is necessary to take into account customer's wishes and benefit.

1 Introduction

The best pattern is different for every firm, and it varies over time. In the 1970s centralized purchasing was popular, with a large staff at corporate level having complete control and doing virtually all the procurement activities. Unfortunately, this model often developed into bloated central organization structures, which made decision-making slow and unresponsive. So firms moved towards faster, more agile decentralized purchasing in the 1980s. Better communications and IT encouraged firms to decentralize all the activities that could be dealt with better by local staff, and centralize only the core tasks. [5].

The target of the study is to illustrate, propose and scientifically clarify the trend and development of project-based purchasing organization - where the main task is to give the customer the required goods - in optimal costs, the required delivery date and highest quality.

2 Purchasing and its competencies, transparency

Due to global competition and the related intense pressure on reducing costs and improving competitiveness, purchasing competencies are one of the key skill sets in every company. In everyday practice, however, mistakes or ignorance occur frequently, costing companies lots of money. It is always necessary to think about how it is possible and necessary to prevent mistakes so that purchasing organizations work effectively.

And that is why it is more than necessary for the customers and their requirements to remain at the forefront and for the purchasing strategy to only follow.

2.1 Transparent purchasing

For many years purchasing and its main task has been talked about especially as the power of transparency, decreasing corruption and reducing costs. The more I think about this idea, the more convinced I am that these are just words, not actions, and I am convinced that a vision and clear goals have to go hand in hand with the management of purchasing, along with managers who are able to predict the direction of the economy and industry and not just blindly fulfill the companies' strategies but be fully involved in them or even change them.

2.1.1 Transparency

Knowledge is savings. So if purchasing is done transparently, it opens the company doors to considerable savings. Transparency combined with the active management of suppliers is the foundation for successful strategic purchasing.

Purchasing experts agree that in today's world a system of managing the supply chains is necessary and gaining in importance. Globalization keeps getting stronger, the competition keeps getting louder and only dynamic markets can now do much more than ever before. It is necessary to evaluate the suppliers and actively review and optimize them; this is the right system for managing the supply chain. Managing the supply

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chains helps strategic purchasing to optimize processes, which improves the performance of purchasing and thereby increases the company's value. So the key factors for success in strategic purchasing are therefore without a doubt the so much discussed transparency, along with the systematic management of suppliers.

2.1.2 So what is transparency

I am not afraid to estimate (without any research) that this word is used every day in all media as well as in day-to-day communication, not only in companies but also in conversations between colleagues and partners.

Verifiable sources define transparency as the requirement of transparent and publicly accessible conduct. That what covers nothing from view is transparent. Institutions as well as procedures applied by modern companies keep getting more and more complicated, which allows them to hide various types of dishonesty and abuse. Of course the people committing them are interested in concealing their actions as much as possible. This applies to both the procedures used by accountants, as well as to the procedures used by public institutions and authorities, where it is necessary to strictly separate public interest from the private interests of the people who are supposed to enforce it. The omnipresent phenomenon of corruption is based on the possibility of the abuse of entrusted means by the people handling them.

Although various types of controls are used to fight corruption in private and public institutions, they always raise the question of who will control the inspectors. The most effective form of control is thus control by the public, which - however - requires the transparency of institutions and their procedures. The requirement of transparency is thus the most effective means of the fight against corruption. In practice this usually means that procedures need to be as simple and understandable as possible to the general public and that clear documents (accounts, meeting minutes, resolutions, etc), which need to be publicly accessible, must exist for each decision and handling of entrusted means¹.

2.1.3 How to implement transparency in purchasing

The first goal should be creating transparency. The simplest way for organizations is having advanced software solutions for tenders and contracts. This will provide a company-wide view of all general agreements and contracts or contractual conditions that are or were considered as the best conditions. By having its own supplier database, the given company also has a transparent overview of all of its suppliers [1]. And last but not least, I am talking about a bid system that would impose and identify the given transparency.

The following can be provided as examples: the SupplyOn² collaboration system, information from suppliers and loan reports on a publicly accessible portal.

The next step towards transparency is an annual analysis: documentation of the purchasing volume in all purchasing fields, whether direct or indirect. This is followed by regular reporting of the attained savings or increased prices, the justification of them and the standard inputting of these data into the central database.

Transparency has no impact if suppliers are not administered in the same database at the same time. This means that qualifying suppliers, evaluating suppliers, their reliability and performance or strategic significance, as well as the support with the management of supplier quality must be managed in a single software system with an integrated process that starts with strategic supplier management and provides support for the qualification, evaluation and development of suppliers. And last but not least, it is always necessary to have feedback or controls in place.

Only when these components fit together in the system is the maximum benefit for purchasing and its transparency created (Figure 1).



Figure 1 Transparency

3 Centralization or decentralization

In industry as well as in public services the main task of purchasing is to specify the job or tender in a clear and meaningful way. This always has several factors that are significant, especially in the current global economic crisis. The share of purchasing and services, whether in public or other jobs, requires a great deal of involvement; purchasing thus takes on a considerable degree of responsibility, the requirements for the management of risks and checks must be defined clearly, and this always raises the question of whether purchasing can be managed in only a centralized or decentralized way.

¹ Source: <http://cs.wikipedia.org/wiki/Transparentnost>

² SupplyOn: <http://www.supplyon.com/start.html>

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In my opinion, purely centralized or decentralized forms of organization are no longer able to deal with the changing and strongly fluctuating needs of customers, especially in project-based organizations, and cannot provide a long-term competitive advantage. My experience has shown that four questions that are appropriate and decisive for tenders must be answered, as they can decide whether purchasing should be oriented more towards centralization or decentralization.

- a) Does purchasing play a key role in the selection of suppliers?
- b) Is there friction in the purchasing organization between needs in various places?
- c) Are centrally prescribed standardized material groups necessary?
- d) Is having a locally managed local organization of purchasing necessary or appropriate?

These questions are often answered -- and usually with a YES -- especially in the area of the comprehensive provision of services, and the answer has to do with the scope and complexity of the organization performing the tender.

In the answer to the question of the need for centrally established standardized needs of material structures, especially the requirements of purchasing controlling as related to transparency play a very important role.

3.1 Global Purchasing

Firms are looking further afield in their search for global suppliers. Manitowoc Company, a large maker of cranes, is searching the world for goods – tyres from China, bearings from the USA, chassis parts from Poland and so on. At Manitowoc, purchasing has been given executive level status, with a senior executive who can lead and manage complex outsourcing and global sourcing decisions, who can establish global supplier relationships and who is knowledgeable about various foreign cultures.

The company recognized that it had to establish this purchasing executive post to be in charge of procurement for its 41 facilities in 14 countries across three divisions. Improving procedures with better performance, ensuring dependable supply from worldwide sources, and redesigned organizational structures – all in support of globalization – are the main thrusts for the future [5].

3.2 Placement of Purchasing Authority

Placement of purchasing authority refers to the location of its decision-making, and particularly the choice between centralized and decentralized organizations. If a senior purchasing executive at corporate headquarters has authority over the majority of an organization's purchases, the organization has centralized authority. If authority for the majority of

purchases is at divisional, business or site level, then an organization has decentralized purchasing authority [5].

The benefits of centralized purchasing are generally greater than those of decentralized purchasing. The foremost of these advantages is increased leverage with suppliers because purchase volumes are much larger. Large volumes allow suppliers to take advantage of scale economies, which they can pass along to the buying firm.

3.3 Risk management

The systematic management of risks in public procurement significantly contributes to a company's overall stability. The purchasing department must have the necessary knowledge and know-how.

The list of risks faced by companies in public procurement or tenders is long and the following list is not complete: natural disasters, bankruptcies of key suppliers, lack of raw materials, dangerous transport routes, political unrest, drastic currency and price fluctuations, environmental pollution, etc. But these unpleasant consequences can quickly raise the following question: If we do our purchasing only close by, what are the threats? Loss of production, supply outages, price increases? Of course it is not possible to identify all risks in advance and avoid them. But who knows, maybe it is and can be realistic, or there is a greater chance to limit the damage by taking early counter-measures or making economic arrangements.

"The economic crisis and volatility on the markets have impacted the world", says Axel Schmidt, senior partner at Roland Berger Strategy Consultants³. So what is the trend in risk management? The awarding and tendering of public contracts is used more and more to hedge against the fluctuations of currency exchange rates or supplier risks." This is demonstrated by Roland Berger in their "Purchasing Excellence" study in which over 500 purchasing managers from all over the world were surveyed. The goal of the study, which was launched in 1999 for already the fourth time, is to identify the key trends in purchasing.

If shopping is a "pleasure" in the private sphere, then it is a highly risky and frustrating matter in the business sphere, as purchasing positively or negatively affects the interests of the company owners, customers as well as employees. Where are the risks? Is the fact that we will not get what we expected, both from the perspective of quality as well as quantity. Sometimes even the price is different from our original calculation. The worst situation is when our customer points out our bad purchase when returning a product that we produced. But we, because of a bad contract with the supplier, are unable to transfer the liability for the defects to the supplier. Then the full impact of the incurred damage goes against our bottom line [2].

³ <http://www.rolandberger.com/media/press/>

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In the current version, the study also took a look at the impact of the financial and economic crisis in 2008 and the focus for 2009. Whereas in the previous years the focus was on process optimization, organizational development and supply chain management, as these were identified as the key trends in purchasing back then, now it is "risk management in an unstable environment" that is at the forefront. The following question remains: Where should small and medium sized businesses acknowledge and specifically identify the risks associated with purchasing so that they can be eliminated or minimized.

3.4 Reducing risks

If we would like to reduce the risks in purchasing, then in my opinion the main building blocks that small and medium sized businesses and project oriented companies can use to avoid them are defined in the following points:

- 1) Improving employee skills and defining a clear structure in purchasing
- 2) A comprehensive strategy in the management of purchasing risks is a key element
- 3) Managing purchasing, which is an ongoing continuous process, whether purchasing attained the goals that were set
- 4) Intense management of supplier quality
- 5) Intense management of the supply chain, including a systematic analysis of supplier liquidity
- 6) Market research
- 7) Professional management of contracts with suppliers, including addendums for securing risks

Purchasing strategies that are focused on highly dynamic and changing suppliers, often combined with radical price negotiations or price instability, can be classified as "high risk". "It is nearly impossible in practice to buy from a much cheaper supplier without increasing the risk," said Philipp Dickmann at a Global Purchasing conference for a world-renowned car manufacturer in Germany. Because the costs and risks associated with logistics processes must also be collected. The crisis solution should also be reflected in prices: for example, expensive. Crisis management should also be reflected in prices. For example, expensive air transport should be replaced by sea transport, which is much cheaper. **Already today flexibility is the decisive competitive selling point and is often more important than the price of the product.** Unfortunately it has also been my experience that this opinion remains in the background compared to the global strategies and goals in purchasing.

Too often, perhaps even more than ever before, suppliers are expected to bear the costs of the risks, including the consequences of currency fluctuations or political instability in their prices, which are usually

negotiated for a longer period of time in advance. Innovations or replacing critical raw materials by raw material reserves can be a certain alternative.

But here it is more than necessary for the purchasing department to work together in the organization with the other departments or divisions as equal partners, for example in new product development or project design.

Unfortunately, this is usually not true in practice, not by a long shot, as according to Roland Berger and his study⁴: 77 percent of respondents stated that purchasing enjoys wide support at the executive level. "Even more alarming is that in almost one half of the companies purchasing is not at the same level as other areas, such as sales, finance and marketing." In 2003 it was two thirds of companies in the given matter. "Especially in Germany we see the purchasing function gaining in importance."

4 A combination of global and local suppliers

We will all surely agree that combining purchasing quantities means savings. But sometimes a misconception arises here that only organizations that are managed centrally and have their central strategy and use global contracts can be successful. Together with the help of local purchasing organizations, it is possible to attain far greater savings than just a globally or centrally managed organization can. Only a few purchasing organizations have the ability to consolidate and centralize purchasing and the expert knowledge of purchasing specialists, global agreements and the ability to negotiate. That is why purchasing organizations must also adapt to multiculturalism and the customers' demands or wishes. Not all material groups are suitable for centralized tenders. Goods with a high degree of standardization and low technical complexity are best suited for centralized purchasing. A differential approach and use of flexible organizations, i.e., decentralized purchasing organizations, must be used for technically demanding and time-consuming elements.

Depending on whether standard supply is concerned or not, purchasing must be near the required support.

4.1 Centralized versus decentralized purchasing

Centralized purchasing - has all the actual purchasing done centrally, typically in the corporate headquarters [6].

Dezentralized purchasing - devolves all purchasing decisions to local facilities [6].

Location:

⁴ Roland Berger Strategy Consultants was founded in 1967 and is one of the leading companies in strategic consulting. Via its 36 offices in 25 countries, the company successfully offers its services on all main international markets.

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Two location issues affect purchasing: where should purchasing decisions be made. And where should suppliers be located:

- Where should be effected buying decision
- Suppliers lokation

Centralization versus Decentralization:

In the single-facility organization, the question is whether decisions should be made by department managers on a decentralized basis or by a central purchasing department. In the multiple-facility organization, the question is whether decisions should be made at the plant or division level or by a central purchasing group based at headquarters. Pros and cons exist for centralized and decentralized purchasing in both the single-facility and multiple-facility settings.

Centralized buying up a majority in those companies where it is possible to combine purchasing volumes and thus have a stronger foundation for price negotiations. Table 1 summarizes the main advantages and disadvantages of centralized and decentralized purchasing.

Tabel 1 Advantages and Disadvantages of Centralized and Dezentralized Purchasing (modified according to [6])

Centralized Purchasing	
Advantages	Disadvantages
Almost invariably makes for more efficient ordering of materials	Detachment of production and according to the needs of individual orders
Forms a basis to gin bargaining advantage	Very little flexibility – discretionary issue where ordered
Eliminates duplication of efforts	Centralized purchasing is little slower and more cumbersome than decentralized purchasing
Helps procuring uniform and consistent materials	
Simplifies purchasing procedure	
Simplifies the payment of invoices	
Permits a degree of specialization among buyers.	
Decentralized Purchasing	
Advantages	Disadvantages
Improved efficiency	Different plants of a large organisation require quite different types of materials
Faster procurement of materials	Loss of influence of the supplier – smaller

	purchasing volume
Control over purchases is no longer remote.	The fact that buying efforts are duplicated across the organization
Decentralized operations are more flexible.	
Department or plants has more control of purchase	
Imprved ability to respond to the needs of the department or plant	
For organizations in which it operates geographically dispersed purchase - this advantage is the efficient to use local suppliers	
Large internatinal company with factories located throughout the word often rely on decentralized structure to meet the requirements of individual races	

5 Case study – a project-based purchasing organization

A case study illustrates the integration of methods for tenders in a project oriented company and purchasing organization of international companies in a system of the production of technically demanding specific elements.

First of all, it is necessary to focus on the optimization of quality and costs, and then on improving the position of the organization of company XY on the public procurement market. And last but not least, it is important to improve the performance of the individual purchasing units as far as the effectiveness of work is concerned, as well as the technical knowledge and flexibility towards a common goal: customer oriented customer requirements.

5.1 Specification of project

What is necessary to introduce and define, if we consider the change and the structure of purchase:

Actions:

1. Defining the key indicators, skills, activities and needs of purchasing organizations
2. Optimizing the supply chain
3. Implementing the purchasing processes along with their optimization

Goal:

- Simplifying the indicators of costs and supplier quality
- Simpler cost reporting structure
- Continuing and developing the purchasing organization

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- Developing the transparency and anti-corruption strategy based on the organization's requirements

Project specification:

- Integrating decentralized purchasing groups in the Europe region
- Specifics of standardized and technically demanding and time-consuming products and their breakdown - preserving the local responsibility of the purchasing department on a technically demanding or time-consuming product delivered with regional powers

5.2 The breakdown of purchasing in Europe

So what should the tasks of purchasing organizations be?

A central purchasing organization combines the activities of a local organization and local purchasing specialists in one person. It is organized and broken down according to the purchasing commodities and according to the organization's valid regulations and processes.

The local organization breaks down the roles of central and local responsibility according to the assigned material commodities (see Figure 2).

The regional breakdown according to the division of Europe (North, South, and East) with the corresponding assignment of plants and individual regional purchasing organizations is illustrated on Figure 3.

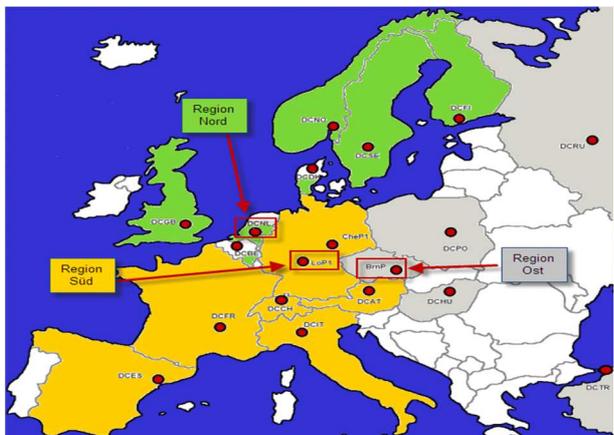


Figure 2 The breakdown of a purchasing organization in Europe

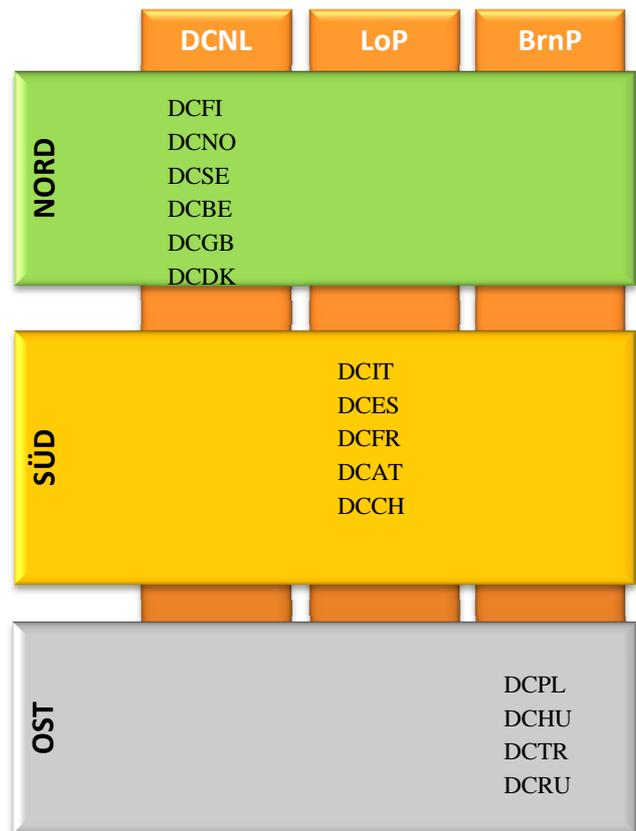


Figure 3 The breakdown of a purchasing organization in Europe by individual countries

6 Conclusion

Managing purchasing successfully means decreasing costs while maintaining quality [2].

The demographic development of the world, its globalization and the subsequent discovery that not everything that is central is best make purchasing organizations ponder what is actually the best? And here I raise another question: Do we really want the best or the most suitable for the customer. And what is the most suitable? [3]

Because often there is no competitor that can provide the much needed feedback, it is necessary for the managers in purchasing or the top executives in the organization to predict what actually is the most suitable. What does the customer really want? Obviously we all know it, but do we really go by it? The customer wants the required quality in the required time at the required price. In the times of strained political and currency impacts and raw materials policies and economic globalization, it is key to install the professional and sustainable management of suppliers and risks and to break purchasing down into centralized and decentralized, or local if you want.

In the following months I would like to present my, their research in the purchase of modern purchasing in a project-based organization. Next steps of research will be devoted to structure of purchasing in the international

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organization, which would be applied in smaller companies focusing just on project management purchasing organization.

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