

Ninth Edition

# PROCUREMENT AND SUPPLY CHAIN MANAGEMENT

Kenneth Lysons  
Brian Farrington

# Procurement and Supply Chain Management

## PEARSON

At Pearson, we have a simple mission: to help people make more of their lives through learning.

We combine innovative learning technology with trusted content and educational expertise to provide engaging and effective learning experiences that serve people wherever and whenever they are learning.

From classroom to boardroom, our curriculum materials, digital learning tools and testing programmes help to educate millions of people worldwide - more than any other private enterprise.

Every day our work helps learning flourish, and wherever learning flourishes, so do people.

To learn more please visit us at [www.pearson.com/uk](http://www.pearson.com/uk)

Ninth Edition

# Procurement and Supply Chain Management

**KENNETH LYSONS**

MA, MEd, PhD, Dipl.PA, Ac.Dip.Ed.,  
DMS, FCIS, FCIPS, FInst M, MILT

**BRIAN FARRINGTON**

BSc(Econ), MSc, PhD, FCIPS

**PEARSON**

Boston Columbus Hoboken Indianapolis New York San Francisco Amsterdam  
Cape Town Dubai London Madrid Milan Munich Paris Montreal Toronto Delhi  
Mexico City São Paulo Sydney Hong Kong Seoul Singapore Taipei Tokyo

**Pearson Education Limited**

Edinburgh Gate  
Harlow CM20 2JE  
United Kingdom  
Tel: +44 (0)1279 623623

Web: [www.pearson.com/uk](http://www.pearson.com/uk)

First published 1981 Macdonald & Evans Limited (print)  
Second edition 1989 Longman Group UK Limited (print)  
Third edition 1993 Longman Group UK Limited (print)  
Fourth edition 1996 Pitman Publishing, a division of Pearson Professional Limited (print)  
Fifth edition 2000 Pearson Education Limited (print)  
Sixth edition 2003 Pearson Education Limited (print)  
Seventh edition 2006 Pearson Education Limited (print)  
Eighth edition 2012 Pearson Education Limited (print)  
**Ninth edition published 2016** (print and electronic)

© Macdonald & Evans Limited 1981 (print)  
© Longman Group Limited 1989, 1993 (print)  
© Pearson Professional Limited 1996 (print)  
© Pearson Education Limited 2000, 2003 (print)  
© Pearson Education Limited 2006, 2012, 2016 (print and electronic)

The rights of Kenneth Lysons and Brian Farrington to be identified as authors of this work have been asserted by them in accordance with the Copyright, Designs and Patents Act 1988.

The print publication is protected by copyright. Prior to any prohibited reproduction, storage in a retrieval system, distribution or transmission in any form or by any means, electronic, mechanical, recording or otherwise, permission should be obtained from the publisher or, where applicable, a licence permitting restricted copying in the United Kingdom should be obtained from the Copyright Licensing Agency Ltd, Barnard's Inn, 86 Fetter Lane, London EC4A 1EN.

The ePublication is protected by copyright and must not be copied, reproduced, transferred, distributed, leased, licensed or publicly performed or used in any way except as specifically permitted in writing by the publishers, as allowed under the terms and conditions under which it was purchased, or as strictly permitted by applicable copyright law. Any unauthorised distribution or use of this text may be a direct infringement of the authors' and the publisher's rights and those responsible may be liable in law accordingly.

All trademarks used herein are the property of their respective owners. The use of any trademark in this text does not vest in the author or publisher any trademark ownership rights in such trademarks, nor does the use of such trademarks imply any affiliation with or endorsement of this book by such owners.

Pearson Education is not responsible for the content of third-party internet sites.

ISBN: 978-1-292-08611-8 (print)  
978-1-292-08614-9 (PDF)  
978-1-292-17067-1 (eText)

**British Library Cataloguing-in-Publication Data**

A catalogue record for the print edition is available from the British Library

**Library of Congress Cataloguing-in-Publication Data**

Names: Lysons, Kenneth, author. | Farrington, Brian, author.  
Title: Procurement and supply chain management / Kenneth Lysons, MA, MEd,  
PhD, Dipl.PA, Ac.Dip.Ed., DMS, FCIS, FCIPS, Flinst M, MILT, Brian  
Farrington, BSc(Econ), MSc, PhD, FCIPS.

Other titles: Purchasing and supply chain management.

Description: Ninth Edition. | New York : Pearson, 2016. | Revised edition of  
the authors' Purchasing and supply chain management, 2012.

Identifiers: LCCN 2016000880 (print) | LCCN 2016001151 (ebook) | ISBN  
9781292086118 | ISBN 9781292086149 (PDF) | ISBN 9781292170671 (eText)

Subjects: LCSH: Purchasing. | Business logistics.

Classification: LCC HF5437 .L97 2016 (print) | LCC HF5437 (ebook) | DDC  
658.7/2—dc23

LC record available at <http://lcn.loc.gov/2016000880>

10 9 8 7 6 5 4 3 2 1  
20 19 18 17 16

Print edition typeset in 10/12pt Goudy Old Style MT Pro by Lumina Datamatics, Inc.  
Printed in Slovakia by Neografia

NOTE THAT ANY PAGE CROSS REFERENCES REFER TO THE PRINT EDITION

Brian Farrington dedicates this book to the memory of Kenneth Lysons, acknowledging all the support he had from his devoted wife, Audrey, and their family.

This book is also dedicated to:

Joyce  
Joanne  
Sandra  
Suzanne  
Claire  
Jake  
Lucy  
Spencer

The support of Ray Gambell a colleague of Brian, with specific research is warmly acknowledged.

This page intentionally left blank

# Contents

<i>Preface</i>	xv
<i>Acknowledgements</i>	xvii
<i>Publisher's acknowledgements</i>	xviii
<i>Plan of the book</i>	xx

## **Part 1** Introduction, strategy, logistics, supply chain, policies and procedures 1

1 The scope and influence of procurement	3
Learning outcomes	3
Key ideas	3
Introduction	4
1.1 How to define procurement	4
1.2 Strategic roles of procurement	5
1.3 Procurement as organisational buying	7
1.4 The evolution of purchasing through to procurement	9
1.5 Procurement and change	15
1.6 World-class procurement	16
1.7 The status of procurement and supply management (PSM)	18
1.8 Reflections on procurement positioning in business	25
Discussion questions	25
References	26
2 Strategic procurement	28
Learning outcomes	28
Key ideas	28
Introduction	29
2.1 Strategic thinking	30
2.2 What is strategy?	31
2.3 Strategy development	32
2.4 Levels of organisational strategy	36
2.5 Corporate strategy	37
2.6 Growth strategies	37
2.7 Business-level strategy	40
2.8 Strategic management	43
2.9 Strategic analysis	43
2.10 Important environmental factors	45
2.11 Internal scrutiny	49
2.12 Strategy formulation	50
2.13 The evaluation of alternative strategies	54
2.14 Strategy implementation	65
2.15 Post-implementation evaluation, control and review	69



2.16 Strategic procurement and supply chain process models	71
Discussion questions	75
References	76
3 Logistics and supply chains	78
Learning outcomes	78
Key ideas	78
Introduction	79
3.1 What is logistics?	79
3.2 Materials, logistics and distribution management	80
3.3 Reverse logistics	85
3.4 Supply chains	86
3.5 Supply chain management (SCM)	89
3.6 Supply chain vulnerability	94
3.7 SCM and logistics	95
3.8 Value chains	95
3.9 Value chain analysis	100
3.10 Supply chain optimisation	103
3.11 Supply chains and procurement	106
Discussion questions	109
References	110
4 Organisational and supply chain structures	112
Learning outcomes	112
Key ideas	112
Introduction	113
4.1 Organisational structures	113
4.2 New type organisations	121
4.3 Networks	122
4.4 Factors in configurations	129
4.5 Lean organisations	132
4.6 Agile organisations and production	135
4.7 Supply and value chain mapping	139
4.8 Types of change	143
4.9 Centralised procurement	146
4.10 Decentralised procurement	148
4.11 Cross-functional procurement	148
Discussion questions	151
References	152
5 Procurement policies, procedures and support tools	155
Learning outcomes	155
Key ideas	155
Introduction	155
5.1 Exemplar Procurement Policy – The Crossrail Project	156
5.2 Procurement procedures	159
5.3 Analysing a procurement process	161
5.4 E-commerce, e-business, e-SCM and e-procurement	161
5.5 The evolution of e-procurement models	165

5.6	Electronic data interchange (EDI)	165
5.7	E-hubs, exchanges, portals and marketplaces	171
5.8	E-catalogues	173
5.9	E-auctions	176
5.10	Reverse auctions	177
5.11	E-payment	182
5.12	Low-value purchases	183
5.13	Procurement manuals	185
5.14	Supplier manuals	187
	Discussion questions	188
	References	189
<b>Part 2</b>	<b>Supplier relationships, legal &amp; contractual management, quality management, sourcing, supplier selection, price management and long-term cost in use</b>	<b>191</b>
6	Supplier relationships and partnering	193
	Learning outcomes	193
	Key ideas	193
	Introduction	193
6.1	Relationship procurement and procurement relationships	194
6.2	The contrast between transactional and relationship procurement, taking account of contractual requirements	194
6.3	Collaborative business relationships	194
6.4	Relationship formation	197
6.5	Models of supplier relationships	199
6.6	Practical considerations of supplier relationship management	205
6.7	The termination of relationships	208
6.8	Relationship breakdown on an IT project	211
6.9	Further aspects of relationships	213
	Discussion questions	213
	References	214
7	Legal and contractual management	216
	Learning outcomes	216
	Key ideas	216
7.1	The procurement specialist and Contract Law	216
7.2	Offer and acceptance	217
7.3	Acceptance	219
7.4	Contracts for the Sale of Goods	221
7.5	Contract for the Supply of Services	222
7.6	Consideration	223
7.7	Capacity to Contract	224
7.8	Drafting the detail of contract clauses	226
7.9	Misrepresentation	227
7.10	The Right to terminate a contract	228
7.11	HOT TOPICS	230
7.12	Standard Forms of Contract	237
	Discussion questions	239
	References	239

8	Quality management, service and product innovation	241
	Learning outcomes	241
	Key ideas	241
8.1	What is quality?	242
8.2	Quality systems	244
8.3	The importance of TQM	244
8.4	Specifications	249
8.5	Alternatives to individual specifications	254
8.6	Standardisation	257
8.7	Variety reduction	262
8.8	Quality assurance and quality control	262
8.9	Tests for quality control and reliability	263
8.10	The cost of quality	275
8.11	Value management, engineering and analysis	276
	Discussion questions	287
	References	288
9	Matching supply with demand	290
	Learning outcomes	290
	Key ideas	290
9.1	Inventory, logistics and supply chain management	291
9.2	Reasons for keeping inventory	291
9.3	Inventory classifications	292
9.4	Scope and aims of inventory management	292
9.5	Some tools of inventory management	294
9.6	The economics of inventory	298
9.7	Inventory performance measures	299
9.8	Safety stocks and service levels	300
9.9	The right quantity	303
9.10	The nature of demand	304
9.11	Forecasting demand	304
9.12	'Push' and 'pull' inventories	310
9.13	Independent demand	311
9.14	Dependent demand	315
9.15	Just-in-time (JIT)	315
9.16	Materials and requirements planning (MRP)	322
9.17	Manufacturing resource planning (MRP II)	326
9.18	Enterprise resource planning (ERP)	327
9.19	Supply chain management systems	330
9.20	Distribution requirements planning (DRP)	330
9.21	Vendor-managed inventory (VMI)	332
9.22	Procurement and inventory	335
	Discussion questions	335
	References	337
10	Sourcing, supplier selection and performance management	338
	Learning outcomes	338
	Key ideas	338
10.1	What is sourcing?	339
10.2	The strategic sourcing process	339

10.3	Sourcing information	341
10.4	Analysis of market conditions	342
10.5	Directives	344
10.6	E-sourcing	345
10.7	Locating suppliers	346
10.8	Supplier assessment	347
10.9	Supplier approval	355
10.10	Evaluating supplier performance	356
10.11	Policy issues in sourcing	359
10.12	The supplier base	360
10.13	Outsourcing	361
10.14	Outsourcing manufacturing	362
10.15	Outsourcing services	367
10.16	Drivers of outsourcing	369
10.17	Types of outsourcing	369
10.18	Benefits of outsourcing	370
10.19	Problems of outsourcing	370
10.20	Handling an outsourcing project	371
10.21	Sub-contracting	373
10.22	Partnering	375
10.23	Intellectual property rights and secrecy	385
10.24	Procurement support for in-house marketing	386
10.25	Intra-company trading	387
10.26	Local suppliers	388
10.27	Procurement consortia	388
10.28	Sustainability	389
10.29	Sourcing decisions	390
10.30	Factors in deciding where to buy	392
	Discussion questions	394
	References	396
11	Purchase price management and long-term cost-in-use	398
	Learning outcomes	398
	Key ideas	398
11.1	What is price?	399
11.2	Strategic pricing – an introduction	399
11.3	The buyer's role in managing purchase prices	400
11.4	Supplier pricing decisions	411
11.5	The supplier's choice of pricing strategy	411
11.6	Price and cost analysis	413
11.7	Competition legislation	417
11.8	Collusive tendering	419
11.9	Price variation formulae	420
	Discussion questions	422
	References	424

<b>Part 3</b>	<b>Project management and risk management, global sourcing, negotiation skills, contract management, category procurement, world-class procurement to enhance business performance</b>	<b>425</b>
12	Project procurement and risk management	427
	Learning outcomes	427
	Key ideas	427
12.1	Introduction	428
12.2	The project lifecycle	428
12.3	PID and the project procurement strategy	433
12.4	Design and build	435
12.5	Role of procurement	436
12.6	PRINCE2®	436
12.7	Project management issues	438
12.8	Project risk management	439
12.9	Project procurement risk management	440
12.10	Project procurement management	447
	Discussion questions	455
	References	455
13	Global sourcing	457
	Learning outcomes	457
	Key ideas	457
13.1	Terminology	458
13.2	Motives for buying offshore	458
13.3	Sources of information for offshore suppliers	459
13.4	Overcoming challenges when sourcing off-shore	460
13.5	Incoterms®	467
13.6	Shipping terms	468
13.7	Customs and Excise	472
13.8	Transport systems, costs and considerations	473
13.9	Freight agents	475
13.10	Methods of payment	477
13.11	Countertrade	479
13.12	The true cost of offshore buying	482
13.13	Buying capital equipment offshore	482
13.14	Factors in successful offshore procurement	484
	Discussion questions	485
	References	485
14	Negotiation skills, practice and business benefits	487
	Learning outcomes	487
	Key ideas	487
	Introduction	488
14.1	Approaches to negotiation	491
14.2	The content of negotiation	492
14.3	Factors in negotiation	495
14.4	The negotiation process	499

14.5	Pre-negotiation	500
14.6	The actual negotiation	506
14.7	Post-negotiation actions	511
14.8	What is effective negotiation?	512
14.9	Negotiation and relationships	512
14.10	Negotiation ethics	514
	Discussion questions	518
	References	519
15	Contract management	521
	Learning outcomes	521
	Key ideas	521
	Introduction	522
15.1	The pre-contract award activities impact on contract management	522
15.2	The contract manager's role, skills and knowledge	523
15.3	Contract management plans	527
15.4	The contract management of specifications/standards	531
15.5	Managing contract performance	534
15.6	Social services contract monitoring audit	536
15.7	Contract management checklist	540
15.8	Contract provisions	541
15.9	Contract clauses and what they mean	542
	Discussion questions	543
	References	544
16	Category and commodity procurement	545
	Learning outcomes	545
	Key ideas	545
	Introduction	546
16.1	Defining categories	546
16.2	Illustrations of category management issues	547
16.3	The talent challenge	549
16.4	Category management risk profiling	549
16.5	Category management – corporate travel	550
16.6	Category management – ICT	554
16.7	Capital investment procurement	556
16.8	Production materials	567
16.9	Raw materials	568
16.10	Futures dealing	569
16.11	Methods of commodity dealing	573
16.12	Procurement of non-domestic gas and electricity	577
16.13	Energy regulation	577
16.14	Energy supply chains in the UK	577
16.15	Markets	578
16.16	Pricing	579
16.17	Procuring energy contracts	580
16.18	Energy consultants and management	582
16.19	Component parts and assemblies	582
16.20	Procurement and consumables	583
16.21	Construction supplies and bills of quantities	584

16.22 Procurement of services	587
Discussion questions	592
References	593
17 World-class procurement to enhance business performance	594
Learning outcomes	594
Key ideas	594
17.1 Innovation and supplier continuous improvement	595
17.2 Innovation	596
17.3 Environmentally sensitive design	597
17.4 Procurement involvement in product development	599
17.5 Supplier development	599
17.6 Procurement research	603
17.7 Procurement performance evaluation	606
17.8 Accounting approaches	610
17.9 The procurement management audit approach	611
17.10 Benchmarking and ratios	616
17.11 Integrated benchmarking	617
17.12 Procurement ethics	619
17.13 Ethical issues relating to suppliers	621
17.14 Ethical codes of conduct	623
17.15 Procurement and fraud	627
17.16 Environmental aspects of procurement	631
Discussion questions	642
References	644
<i>Appendix 1: Code of professional ethics – Chartered Institute of Procurement and Supply (CIPS) (Approved by the CIPS Council, 11 March 2009)</i>	646
<i>Appendix 2: Principles and standards of ethical supply management conduct (ISM) (Adopted May 2008)</i>	648
<i>Definitions, acronyms and foreign words and phrases</i>	649
<i>Index of names and organisations and some publications mentioned in the text</i>	655
<i>Subject Index</i>	660

### Supporting resources

Visit [www.pearsoned.co.uk/farrington](http://www.pearsoned.co.uk/farrington) to find valuable online resources

#### For Instructors:

- Comprehensive Instructor’s Manual containing teaching tips and notes on case studies for each chapter
- Downloadable PowerPoint slides containing figures from the book

For more information please contact your local Pearson Education sales representative or visit [www.pearsoned.co.uk/farrington](http://www.pearsoned.co.uk/farrington)

Dr Brian Farrington is the author of the ninth edition of the acclaimed book, originally created by the late Dr Kenneth Lysons. The procurement profession continues to rise to national and international challenges, whilst at the same time contemplating its role in corporate matters. The global economy remains unstable. The private sector requires a competitive edge to survive. The public sector requires cost effective provision of services. The procurement and supply chain profession is in a unique position to help deliver these ideals.

The ninth edition has been reengineered to make the content of immediate benefit to students and practitioners alike. Accordingly, there are a number of important points to make.

- 1 The content reflects the emphasis of the Chartered Institute of Procurement and Supply (CIPS) education syllabus and modern world-class practice. There are innovative inputs, including contractual issues and hot topics, contract management and category management.
- 2 The content is informed by Dr Farrington's international research and real-life consultancy experiences in the private and public sectors. His experience spans many sectors, including automotive, aerospace, defence, shipbuilding, mining, airlines, financial services and government departments.
- 3 Some of the changes have been influenced by active contact with readers, practitioners and specialists in other functions, particularly legal, financial, audit and operations management.
- 4 The author is an active change agent and is professionally driven to enhance the reputation of procurement and supply chain performance. This new edition aims to be informative, challenging, thought provoking and a stimulus for further learning. The literature is increasing and that is welcome.
- 5 Case studies and CIPS examination questions are now provided at the end of the book. There are the author's discussion questions at the end of each chapter. This will assist tutors and learners to test their learning in a structured manner.

Finally, to procurement and supply chain practitioners, there is a wealth of reference material designed to enable specific research to be undertaken in specialist areas.



This page intentionally left blank

# Acknowledgements

Brian Farrington is indebted to many organisations and people who gave their valuable time and support in the preparation of this book. They know who they are and how much it is appreciated.

Sandra Small has pride of place in my acknowledgements. She has coped superbly well with an author reengineering a book, the management of tight timescales and supporting the extensive research. Her attention to detail and diligence in all facets of her tasks is beyond reproach.

Joyce, my wife, continues to provide unstinting support and tolerates my selfish desire to work all hours of the day and night. Without this support there would not be a book!

Caitlin Lisle at Pearson has given me the expert guidance and advice needed for a project of this type. The quality of the book would not have been possible within the timescale without Caitlin's help.

Finally, my thanks go to CIPS for their permission to include their case studies and examinations questions in this ninth edition.

# Publisher's acknowledgements

We are grateful to the following for permission to reproduce copyright material:

## Figures

Figures 1.3, 1.4 from *Improving Purchase Performance*, Pitman (Syson, R. 1992) pp. 254–5; Figure 2.5 adapted from *Competitive Strategy: Techniques for Analysing, Industries and Competitors*, Macmillan (Porter, M. 1980), With the permission of The Free Press, a Division of Simon & Schuster, Inc. Copyright © 1980. All rights reserved; Figure 2.10 adapted from Purchasing must become supply management, *Harvard Business Review*, Sept/Oct, pp. 109–17 (Kraljic, P. 1983), Reprinted by permission of Harvard Business Review. Copyright © 1983 by the Harvard Business School Publishing Corporation. All rights reserved; Figure 2.14 from Rob Atkins and Bracknell Forest (UK) Borough Council; Figures 2.16, 2.17, 2.18 adapted from [http://www.cips.org/Documents/Resources/PSM\\_model\\_Feb03.pdf](http://www.cips.org/Documents/Resources/PSM_model_Feb03.pdf); Figure 3.11 adapted from Supply chain management: implementation, issues and research opportunities, *The International Journal of Logistics Management*, Vol 9(2), p. 2 (Lambert, D.M., Cooper, M.C. and Pagh, J.D. 1992); Figure 3.15 adapted from Integrated materials management: the value chain redefined, *International Journal of Logistics Management*, Vol 4(1), pp.13–22 (Hines, P. 1993); Figures 3.16, 3.17 from Bourton Group, *Half delivered: a survey of strategies and tactics in managing the supply chain in manufacturing businesses*, 1997, pp. 26–7; Figure 4.7 from *Industrial Technological Development: A Network Approach*, Croom Helm (Hakansson, H. 1987); Figure 4.8 adapted from Managing 21st century network organisations, *Organizational Dynamics*, Vol 20(3), pp. 5, 20 (Snow, C.C., Miles, R.E. and Coleman, H.J. 1992); Figure 4.9 from New organizational forms for competing in highly dynamic environments, *British Journal of Management*, Vol 7, pp. 203–18 (Craven, D.W., Piercy, N.F. and Shipp, S.H. 1996), Reproduced with permission of Blackwell Scientific via Copyright Clearance Center; Figure 5.7 from *The e-Business Study*, ACTIVE Secretariat (2000) p. 20; Figure 5.10 from *The CIPS E-procurement guidelines: measuring the benefits*, CIPS; Figure 6.1 adapted from Regional competence and strategic procurement management *European Journal of Purchasing and Supply Management*, Vol 2(1), pp. 386–405 (Cox, A. 1996); Figure 14.4 adapted from *Marketing by Agreement: A Cross-cultural Approach to Business Negotiations*, Wiley (McCall, J. M., and Norrington, M. B. 1986), Reproduced with permission of Blackwell Scientific via Copyright Clearance Center; Figure 14.5 adapted from Effect of delivery systems on collaborative negotiations for large-scale infrastructure projects, *Journal of Management in Engineering*, April 2001, pp. 105–21 (Pena-Mora, F., and Tamaki, T.); Figure 14.8 adapted from *Breaking the Impasse*, Basic Books (Susskind, L. and Cruikshank, J. 1987).

## Tables

Table 1.2 adapted from Procurement: a competitive weapon, *Journal of Purchasing and Materials Management*, Vol 24 (3), pp. 2–8 (Reck, R. F. and Long, B. 1998); Table 1.3 from Procurement: a competitive weapon, *Journal of Purchasing and Materials Management*, Vol 24(3), pp. 2–8 (Reck, R. F. and Long, B. 1998); Table 4.2 from An initial classification of supply networks, *International Journal of Operations and Production*

*Management*, Vol 20(6) (Lamming, R., Johnsen, T., Zheng, J. and Harland, C. 2000); Table 4.3 from A taxonomy of supply networks, *Journal of Supply Chain Management*, Vol 37(4), pp. 21–7 (Harland, C., Lamming, R.C., Zheng, J. and Johnsen, T.E. 2001), Reproduced with permission of Blackwell Scientific via Copyright Clearance Center; Table 4.4 from New organizational forms for competing in highly dynamic environments, *British Journal of Management*, Vol 7, pp. 203–18 (Craven, D.W., Piercy, N.F. and Shipp, S.H. 1996), Reproduced with permission of Blackwell Scientific via Copyright Clearance Center.

# Plan of the book

<b>Part 1 Introduction, strategy, logistics, supply chain, policies and procedures</b>					
Chapter 1 The scope and influence of procurement	Chapter 2 Strategic procurement	Chapter 3 Logistics and supply chains	Chapter 4 Organisational and supply chain structures	Chapter 5 Procurement policies, procedures and support tools	
<b>Part 2 Supplier relationships, legal &amp; contractual management, quality management, sourcing, supplier selection, price management and long-term cost in use</b>					
Chapter 6 Supplier relationships and partnering	Chapter 7 Legal and contractual management	Chapter 8 Quality management, service and product innovation	Chapter 9 Matching supply with demand	Chapter 10 Sourcing, supplier selection and performance management	Chapter 11 Purchase price management and long-term cost-in-use
<b>Part 3 Project management and risk management, global sourcing, negotiation skills, contract management, category procurement, world-class procurement to enhance business performance</b>					
Chapter 12 Project procurement and risk management	Chapter 13 Global sourcing	Chapter 14 Negotiation skills, practice and business benefits	Chapter 15 Contract management	Chapter 16 Category and commodity procurement	Chapter 17 World-class procurement to enhance business performance

## Part 1

Introduction, strategy, logistics, supply chain, policies and procedures

This page intentionally left blank

# Chapter 1

## The scope and influence of procurement

### *Learning outcomes*

This chapter aims to provide an understanding of:

- the scope and influence of procurement
- the stages of procurement development and future trends in procurement development
- factors influencing the internal and external status of procurement
- the strategic dimensions of procurement
- demands for change in the strategic business role of procurement
- characteristics of world-class procurement
- future challenges for procurement.

### *Key ideas*

- Procurement as a function, process, supply or value chain link, a relationship, discipline and profession.
- Definitions of purchasing and procurement.
- The evolution of procurement and supply management (PSM) from a reactive transactional to a proactive strategic activity.
- Globalisation, information technology, changing production and management philosophies as factors in the evolution of procurement.
- Characteristics of world-class procurement.
- Leverage, focus and professionalism as factors contributing to the status of procurement within an organisation.
- Procurement as a business change agent.
- Procurement as a key influencer on business decisions.



## Introduction

The first edition of this book was published in 1981. The ninth edition is published in 2016. The fact that thirty five years has passed warrants reflection on the scope and influence of procurement. The optimist will assert that:

- procurement is a profession in its own right
- procurement has visibility at a corporate level
- procurement offers an excellent career choice
- procurement directly impacts on corporate performance
- academic standards have dramatically improved
- chartered status of the Institute of Procurement and Supply exerts world-wide influence.

The pessimist will assert that:

- there is little intellectual context to procurement
- there is no requirement for continuous learning
- there is too much emphasis on price
- in many organisations, procurement is not a respected activity
- insufficient attention is given to risk management and mitigation strategies
- procurement is not an active contributor to corporate strategic planning.

The emphasis of this edition is procurement, although other terms for the function are in widespread use throughout the world.

The author believes, passionately, that procurement has achieved high standards but has far to go in the corporate world. A key purpose of this book is to inform and motivate you the reader. We want to make them inquisitive and aspire to the highest standards.

### 1.1 How to define procurement

CIPS Australia<sup>1</sup> motivated a debate on an agreed procurement lexicon. The following statements were proposed:

Procurement is the business management function that ensures identification, sourcing, access and management of the external resources that an organisation needs or may need to fulfil its strategic objectives.

Procurement exists to explore supply market opportunities and to implement resourcing strategies that deliver the best possible supply outcome to the organisation, its stakeholders and customers.

Procurement applies the science and art of external resource and supply management through a body of knowledge interpreted by competent practitioners and professionals.

When CIPSA set out to identify the key issues for Australian procurement professionals they undertook a survey of those active in the profession. In summary they concluded,

The survey responses indicate that there is a wide variation in the intended meaning of the terms we use. Many are used interchangeably, even loosely, by some, but have specific meanings to others. The word 'purchasing' is a good example. It can be an all-encompassing term synonymous with 'supply management' and 'procurement' or it can indicate just one step in a

much-bigger process. Such variation is of concern as it could lead to miscommunication and hinder the development and sharing of our body of knowledge. A concern, at the most fundamental level, is that unless we can describe what we do and demonstrate our success to our stakeholders we cannot win their recognition and support.

The author provides two more definitions of procurement.

Procurement is a pro-active, strategic corporate activity to ensure a continuing supply of goods and services to enable world-class organisational performance.

Procurement manages supply chain risks through the effective negotiation of contracts, cost and price models, quality and other essential supply characteristics.

## 1.2 Strategic roles of procurement

There are unquestionable operational and tactical roles of procurement, such as agreeing the price; placing purchase orders; attending meetings; chasing overdue deliveries; handling stakeholder queries and handling order acknowledgements. These are all necessary roles but they fail to highlight any strategic dimension. The strategic facets are notably absent from some of the literature.

### 1.2.1 Due diligence

Due diligence is a structured methodology to help determine that a supplier has the necessary qualities to become a partner of the buying organisation. The term ‘due diligence’ is more usually associated with financial reviews in takeover situations. Within a procurement context it includes consideration of the supplier’s:

- financial robustness, including working capital
- competence and availability of key resources
- reliance and extent of sub-contracting
- history of legal disputes and litigious actions
- experience of partnering relationships
- existence of a robust five-year business plan
- history of insurance claims
- IT system robustness.

Conducting due diligence is a far more demanding task than reading responses to a Pre-Qualification Questionnaire. It requires probing beyond a superficial scrutiny of written answers to questions.

### 1.2.2 Risk Management of the supply chain

Identifying supply chain risks and developing acceptable risk mitigation strategies is a hallmark of a strategically focused procurement operation. All supply chain risks fall into one of three categories:

- 1 Those risks that only the supplier can manage
- 2 Those risks that only the buying organisation can manage
- 3 Those risks that must be jointly managed by the supplier and the buying organisation.

Examples of risks that fall into category 1 are:

- Having a robust business continuity plan
- Ability to match resource planning to programme deliverables
- Contractual relationships with sub-contractors
- Design, inspection and testing
- Having available sufficient working capital
- Through life product support.

### 1.2.3 Relationship management

The adversarial approach to business life is an outdated concept, a fact that some procurement specialists should realise. The skill of managing relationships with strategic suppliers necessitates attention to, for example:

- conducting regular blame free reviews of contract performance
- a joint commitment to continuous improvement
- sharing long-term business goals
- active involvement of senior people at both organisations
- negotiations based on genuine business objectives
- provision of accurate and timely business and contract management data.

### 1.2.4 Continuous improvement of supplier performance

All sectors of the economy have competitive challenges, sometimes from off shore organisations. The procurement community has a strategic role to motivate suppliers to continually improve their performance. The performance on long-term contracts can be incentivised to reward the supplier's investment and initiatives. The contract can require continuous improvement as an obligation. In some situations the buying organisation may jointly invest in new technology, providing the supplier agrees to appropriate ownership of intellectual property and perhaps licensing upon payment of a royalty on sales.

### 1.2.5 The supplier's investment in 'right first time'

An organisation's reputation for quality is a prime business asset. The law courts regularly try cases where non-compliance with the specification is at issue. Suppliers have expert knowledge, or should have, of the goods or services they provide. The supplier can add value to a procurement by ensuring that the specified quality is satisfied or exceeded. The supplier can also advise on through life costs, maintenance support, inspection and testing and continuous improvement. When the procurement specialist is engaged in pre-qualification processes, there should be a penetrating analysis of the bidder's quality management attributes.

### 1.2.6 The supplier's investment in inventory

The rapid business approach to Just-in-Time has focused attention on who pays for inventory in the supply chain pipeline. Buying organisations are naïve to believe this is a

‘free of charge’ service, willingly entered into by the supplier. There are costs involved, including strategic warehousing facilities, distribution network costs, danger of product changes, working capital costs and so on. The concept of consignment stock is a proven concept in manufacturing, with some suppliers very adept at completely satisfying the buyer’s needs for production line side stock.

### 1.2.7 The supplier’s investment in procurement expertise

It is a strange phenomenon that when buyers visit potential suppliers they often fail to probe the supplier’s investment in procurement expertise. When the author engages with clients engaged in a tendering exercise and the supplier makes a presentation, it is most unlikely that there will be a procurement specialist on their team. Why? It can only be concluded that their procurement operation is not seen as contributing to their competitive edge.

## 1.3 Procurement as organisational buying

Organisational buyers have been defined by Marrian<sup>2</sup> as:

Those buyers of goods and services for the specific purpose of industrial or agricultural production or for use in the operation or conduct of a plant, business, institution, profession or service.

Organisational buyers are therefore those who buy on behalf of an organisation rather than for individual or family use or consumption. As shown in Table 1.1, organisational buyers can be considered to belong to one of four buying groups, each of which can be further subdivided.

Some of the categories in Table 1.1 may overlap. In the National Health Service, for instance, some supplies may be bought centrally by government agencies, regionally by health authorities and locally by hospitals themselves.

**Table 1.1** A typology of organisational buyers

<i>Types of organisation</i>	<i>Characteristics</i>	<i>Examples</i>
Industrial/producer organisations	Purchase of goods and services for some tangible production and commercially significant purpose	Manufacturers: primary (extractive) producers – agriculture, forestry, fishing, horticulture, mining
Intermediate organisations	Purchase of goods and services for resale or for facilitating the resale of other goods in the industrial or ultimate consumer markets	Distributors, dealers, wholesalers, retailers, banks, hotels and service traders
Government and public-sector organisations	Purchase of goods and services for resale or use by organisations providing a service, often tangible, and not always commercially significant at national, regional and local levels	Central and local government, public utilities
Institutions	Purchase of goods and services for institutions that buy independently on their own behalf	Schools, colleges, hospitals, voluntary organisations

### 1.3.1 Procurement as supplier management

Supplier management may be defined as:

That aspect of procurement concerned with rationalising the supplier base and selecting, coordinating, appraising the performance of and developing the potential of suppliers and, where appropriate, building long-term collaborative relationships.

Supplier management is a more strategic and cross-functional activity than ‘buying’, which is transactionally and commercially biased. The relationship between procurement, purchasing and supplier management is shown in Figure 1.1.

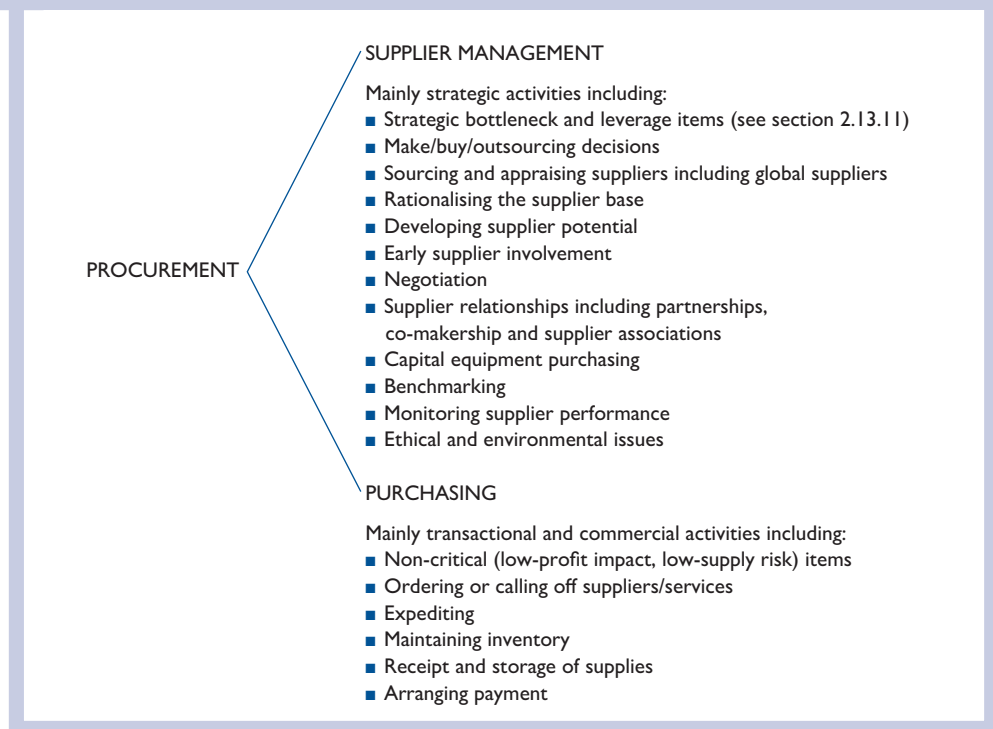
### 1.3.2 Purchasing as external resource management

The following is the view of Lamming:<sup>3</sup>

The new strategic function will probably not be called purchasing – that is much too limited a word. The connotations of purse strings and spending money have no relevance to the setting up and management of strategic interfirm relationships. This task is concerned with ensuring the correct external resources are in place to complement the internal resources. Perhaps ‘external resource managers’ is a term that future purchasing managers will adopt.

Lamming’s view, expressed in 1985, has literally come to pass. The emphasis is now on procurement.

Figure 1.1 The relationship between procurement, supplier management and purchasing



## 1.4 The evolution of purchasing through to procurement

Procurement represents a stage in the evolution of civilised human relationships as it enables a desired object to be obtained by trading rather than conquest, plunder or confiscation. It is a very ancient activity. A cuneiform clay tablet excavated at Ras Shamra, northern Syria, dated about 2800 BC, carries an inscription that, roughly translated, reads:

HST to deliver 50 jars of fragrant smooth oil each 15 days after [a starting date] and during the reign of AS. In return he will be paid 600 small weight in grain. This order will continue indefinitely until the purchaser or his son removes his consent.

The evolution of purchasing and procurement can be analysed in seven periods.

### Period 1: The early years (1850–1900)

Some observers define the early years of procurement history as beginning after 1850. Evidence exists, however, that the procurement function received attention before this date. Charles Babbage's book on the economy of machinery and manufacturers, published in 1832, referred to the importance of the procurement function. Babbage also alluded to a 'materials man' responsible for several different functions. Babbage wrote that a central officer responsible for operating mines was 'a materials man who selects, purchases, receives, and delivers all articles required'.

The greatest interest in and development of procurement during the early years occurred after the 1850s – a period that witnessed the growth of the American railroad. By 1866, the Pennsylvania Railroad had given the procurement function departmental status, under the title of Supplying Department. A few years later, the head procurement agent at the Pennsylvania Railroad reported directly to the president of the railroad. The procurement function was such a major contributor to the performance of the organisation that the chief procurement manager had top managerial status.

The comptroller of the Chicago and North Western Railroad wrote the first book exclusively about the procurement function, *The Handling of Railway Supplies – Their Purchase and Disposition*, in 1887. He discussed procurement issues that are still critical today, including the need for technical expertise in procurement agents along with the need to centralise the procurement department under one individual. The author also commented on the lack of attention given to the selection of personnel to fill the position of procurement agent.

### Period 2: Growth of procurement fundamentals (1900–1939)

The second period of procurement evolution began around the turn of the twentieth century and lasted until the beginning of the Second World War. Articles specifically addressing the industrial procurement function began appearing with increasing regularity outside the railroad trade journals. Engineering magazines in particular focused attention on the need for qualified procurement personnel and the development of material specifications.

Procurement gained importance during the First World War because of its role in obtaining vital war materials. This was due largely to procurement's central focus of raw material procurement during this era (versus buying finished or semi-finished goods). Ironically, the years during the First World War featured no publication of any major procurement books. Harold T. Lewis, a respected procurement professional during the 1930s through the 1950s, noted that there was considerable doubt about the existence of any general recognition of procurement as being important to a company. Lewis noted that from the First World War to 1945, at least a gradual if uneven recognition developed of the importance of sound procurement to company operation.