

Kenneth Lysons | Brian Farrington

PROCUREMENT AND SUPPLY CHAIN MANAGEMENT

Tenth Edition

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Procurement and Supply Chain Management



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Tenth Edition

Procurement and Supply Chain Management

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Dedications

I dedicate this book to my family. They mean everything to me. In particular, to Joyce, my wife, who has unstintingly supported me throughout my career. She is without comparison.

I also dedicate this book to the memory of Kenneth Lysons. Ken's devoted wife, Audrey, and their family continue to be a source of inspiration to me. This relationship has extended over many years and is greatly valued.

Brian Farrington

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Preface

Dr Brian Farrington is the author of the tenth edition of this acclaimed book. The output of any book is influenced by many sources, including:

- professional feedback from lecturers at Universities and Colleges; their views are invaluable
- the Chartered Institute of Procurement and Supply’s education syllabus and the Institute’s continual quest to enhance standards
- legal challenges to procurement decisions
- emphasis on environmental and socially responsible procurement
- feedback from learners and practitioners
- the author’s international consultancy experience
- the recognition that a procurement specialist has to exercise the highest moral and ethical standards and that some fall short
- the challenge presented by cyber security.

There are two new chapters, thanks to the foresight of Pearson.

Public Sector Procurement is a new chapter, recognising the public sector’s impact on the global economy. Public accountability means that scrutiny of decisions is far more open than the private sector.

Sustainability and Socially Responsible Procurement is a new chapter, recognising that this is a highly challenging global issue wherein procurement has great influence. More initiatives are necessary.

There has been a serious recasting of much of the content. There is an unrivalled opportunity for procurement specialists to manage risk, finance and corporate performance. The author seeks to instil in all procurement specialists the fact that effective and innovative procurement pays a significant part in the management of economies and corporate performance.

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Writing a book of this complexity requires the support, advice and patience of many people. The challenges, frustrations and achievements are never solely down to the author. I am indebted to many organisations and people who have materially assisted. By exception, Joe Anwyll, has provided me with constant professional opportunities and challenges. These have kept me focused.

Sandra Small has, again, risen to every challenge I have faced her with. The changes made to this edition have presented Sandra with severe timescales and technical issues. She has risen to these with unquestionable diligence and expertise.

Joyce, my wife, has tolerated, with the utmost goodwill, my absolute focus on getting the tenth edition of the book finished to meet an exacting deadline.

It would be remiss not to acknowledge the 'new' relationship with the Pearson team in India. The help and support of Bincy Menon, Agnibesh Das and Vinay Agnihotri have been vital. It can truly be said to have been an experience! Louise Attwood's attention to detail during the copyediting process has ensured the book is of the highest quality.

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Part 1

Introduction and strategy

Chapter 1

The scope and influence of procurement

Learning outcomes

This chapter aims to provide an understanding of:

- how to define procurement
- how to define supply chain management
- strategic roles of procurement
- procurement as organisational buying
- the strategic scope of procurement
- integrated supply chain management
- procurement and change
- world-class procurement
- the status of procurement and supply management
- reflections of procurement positioning in business
- the scope of procurement in the public sector

Key ideas

- Procurement as a function, process, supply or value chain link, a relationship, discipline and profession.
- Procurement as a strategic business activity.
- Definitions of purchasing, procurement and supply chain.
- 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. This, the tenth edition, is published in 2020. The procurement profession has achieved some notable successes. These include:

- it is recognised by many as a profession
- a dramatic improvement in academic standards and research
- active involvement at a corporate strategy level
- career opportunities on an international basis
- Chartered Institute of Procurement & Supply impact on standards
- wide-ranging, positive initiatives to deliver corporate goals.

Despite the successes, there remain critical allegations related to facets of procurement performance where failures are apparent. These include:

- absence of long-term strategies to support corporate goals
- an inability to play a decisive role on major projects, including ICT and construction
- a failure to impose robust contract terms and conditions on suppliers and contractors
- an inability to conduct due diligence and to identify high level risks in the supply chain
- inadequate involvement and influence on contract management activities
- an inability to adequately evaluate procurement workloads and staff to meet the forward business challenges.

Throughout this book, procurement is the focus term, recognising that the function has other descriptors, including purchasing and buying.

The author is resolute in his belief that procurement warrants corporate recognition. The key purposes of the book are to inform, motivate and convince our readers that the highest personal standards and knowledge impact on performance.

1.1 How to define procurement

CIPS Australia¹ 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.

The author offers 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 effective negotiation of contracts, cost and price models, quality and other essential supply characteristics.

1.2 How to define supply chain management (SCM)

Investopedia² define supply chain management (SCM) as ‘Supply chain management is the management of the flow of goods and services and includes all processes that transform raw materials into final products. It involves the active streamlining of a business’s supply-side activities to maximise customer value and gain a competitive advantage in the market place.’

Techopedia³ define SCM as ‘The management and oversight of a product from its origin until it is consumed. SCM involves the flow of materials, finances and information. This includes product design, planning, execution, monitoring and control.’

1.3 Strategic roles of procurement

The strategic ability and contribution of procurement is the differentiator that sets the function apart from a transactional modus operandi. Boeing, in developing its 787 Dreamliner, expanded the role of procurement from outsourcing parts to outsourcing entire subsections. It has been estimated that nearly all of the jet’s design and fabrication, along with some 40 per cent of the estimated \$8 billion in development costs, is being outsourced to subcontractors.

1.3.1 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 personnel resources
- reliance and extent of sub-contracting
- history of legal disputes and litigious actions
- experience of partnering relationships
- existence of a robust 5-year business plan
- history of insurance claims
- IT system robustness.

Conducting due diligence requires specialist knowledge and skills. It also requires liaison and collaboration with in-house specialists in areas including finance, legal and security.

1.3.2 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.

1.3.3 Relationship management

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

- conducting regular blame free reviews of contracts
- 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
- the provision of accurate and timely business and contract management data.

1.3.4 Continuous improvement of supplier performance

All sectors of the economy have competitive challenges, sometimes from off-shore organisations. The procurement community have 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.

1.3.5 The supplier's investment in 'right first time'

An organisation's reputation for quality is a prime business consideration. 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 can be 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.

1.3.6 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 of completely satisfying the buyer's needs for line side stock.

1.3.7 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 a competitive edge.

1.4 Procurement as organisational buying

Organisational buyers have been defined by Marrian⁴ 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 those who buy on behalf of an organisation rather than for individual or family use or consumption. Organisational buyers can, as shown in Table 1.1, 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. Thus, in the National Health Service, 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

1.4.1 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.

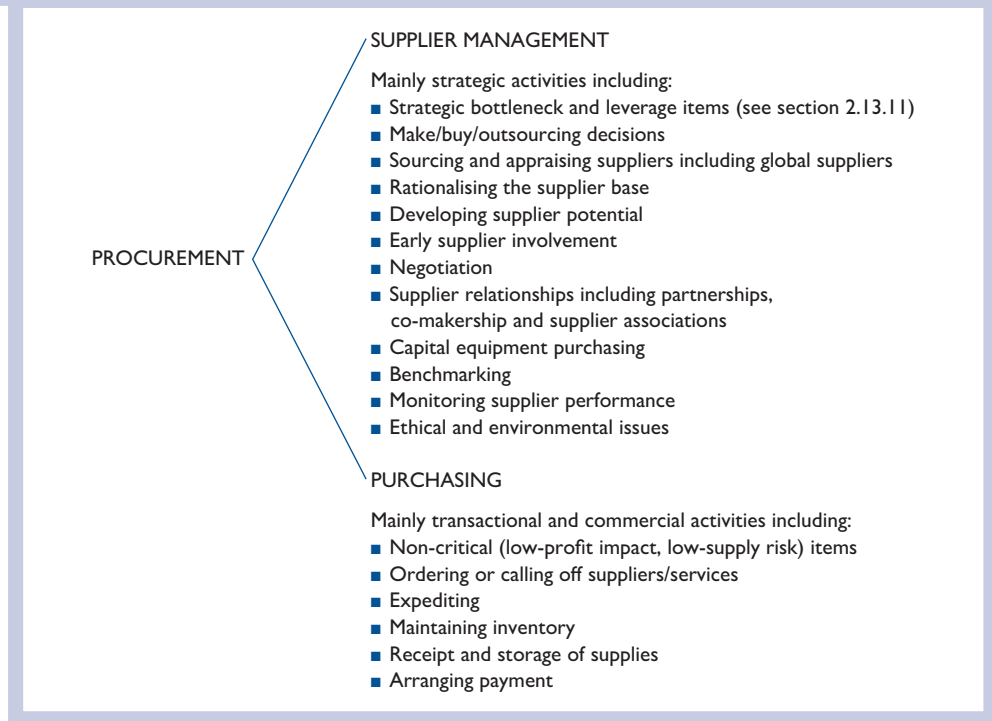
Supplier management is a more strategic and cross-functional activity than ‘buying’, which is transactionally and commercially biased. The relationship between procurement purchasing and supplier management is shown in Figure 1.1.

1.4.2 Purchasing as external resource management

The following is the view of Lamming:⁵

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.

Figure 1.1 The relationship between procurement, supplier management and purchasing



1.5 The strategic scope of procurement

The strategic scope of procurement will vary according to the nature of the organisation's business activities. The author has consulted in, for example, a gold mining organisation and an international deep-sea communication cable laying organisation. The strategic variables were quite different. The principles of strategic scope are illustrated by Figure 1.2.

Each of the key areas shown in Figure 1.2 is analysed and shown in tabular form in Tables 1.2 to 1.7. Table 1.2 provides indicative areas of financial strategic considerations including the corporate strategic relevance. All the considerations and relevance are pertinent to procurement decision making. Table 1.3 concentrates on the legal strategic considerations of important relevance to procurement decisions making. Table 1.4 examines supply chain risks, including the corporate strategic relevance. All these considerations should be within the scope of procurement influence and action. Table 1.5 deals with operational strategic matters again emphasizing the areas in which procurement can play a major role. Table 1.6 raises the technology strategic considerations, outlining the potential scope and influence of procurement. Table 1.7 deals with managing obstacles to change and emphasizes the continuing potential influencing skills of procurement specialists.

1.5.1 Finance – strategic scope of procurement

Table 1.2 provides indicative areas of financial strategic considerations for procurement.

Figure 1.2 Strategic scope of procurement – key areas

