

Taking a 'whole supply chain' view

The customer or consumer is at the end of what can be a long chain of firms and activities, each component of which should add value to the product or service being produced.

Any part of the chain which is inefficient or too costly passes on this cost to the final customer, even if they are several steps further along. Some of these costs may be hidden or masked by the interfaces and relationships within the chain; for instance one particularly efficient activity might compensate for another inefficient one, with the result that the problem is not apparent in the overall process and total supply chain. Also inefficiencies in one organisation's operation might be hidden, for instance by demanding lower prices from its suppliers to compensate. Again the impact upon the final product or service may not show this up. Also this can only be a short-term fix which could eventually lead to customers switching to competing firms or supply chains which might offer more streamlined processes and hence more competitive products or services. Firms may think they are internally operating efficiently, when in fact the total supply chain of which they are a part might be uncompetitive compared to others. It also suggests that within a supply chain there could be significant room for cost cutting or improving efficiency.

In order to identify potential problems, purchasers and supply chain managers must make themselves aware of the activities going on both upstream and downstream, which in turn shows that the knowledge and understanding of procurement professionals must extend into the other organisations within the supply chain. Supply chain management becomes the alignment of all involved organisations to ensure that the maximum efficiency is gained, and the weeding out of costly or ineffective activities. This also includes making the interfaces between firms as effective as possible, where a lack of mutual understanding or agreement, or

legal or bureaucratic processes could hinder the transitions between firms. Value 'flows' along the chain (this is where Farmer's use of the supply pipe is a somewhat better metaphor) and any impediments to its smooth flowing need to be removed. This leads into the next consideration.

Think supply networks not supply chains:

Although it has become part of the standard terminology of procurement and business more generally, it is perhaps better to think about supply networks rather than chains. The chain supposes a linear process from end to end, but the reality of an organisation's procurement activities may not be quite so straight, or straightforward. Firms can be involved in many different supply chains, and might have simultaneous roles of supplier and buyer. Construction firms are a good example of this, where participation in many simultaneous projects, as supplier, sub-contractor or contractor is not uncommon. A network approach allows more complex sets of relationships with other firms to be considered, and encourages the purchaser to participate in the maintenance and improving of relationships throughout the network which involves both purchase and supply, rather than taking a unilateral view which emphasises the upstream interfaces with customers at the expense of relations with suppliers. (see again fig 2).

Concentrate on the firm's core competencies:

The firm can be viewed as consisting of 'core competencies' which are essential in order to compete in the market, and to be differentiated from competition, and other, less important or 'non-core' competencies. This approach can be used to consider which skills and activities to retain in house, and which to outsource; if the

costs of owning a non-core competency are higher than sourcing it externally, and the risks of non ownership within the market are low, then the activity can be safely outsourced, or bought in. But this is perhaps not as simple as it might appear, and brings with it questions over how the organisation should be structured and what the boundaries of the firm should be within a wider context of supply chains and networks. Following Williamson's (1975) theory of transaction cost management we can also argue that certain forms of organisation are better suited to some organisational goals than others, and different firms bring with them different types of transaction cost. As well as inter-organisational relationships, the structuring and organisation of the firm itself are key in attaining desired outcomes, and will be subject to continual change and adaptation as firms strive for greater efficiency and competitiveness, and develop these relations.

Decisions need to be made over what type of external and internal relationships best fit with an organisation's goals and strategic procurement has an important part to play in these decisions. Williamson argues that the criteria for making these type of decisions resides in the 'scope for economising' or what leverage exists for reducing input costs into the organisation, and the 'specificity of the assets' or what existing investments have been made in different activities, and how these link to the core competencies, of the firm, and its differentiation or positioning more generally in supply networks and markets.

However, although this poses a major challenge for the firm in reviewing, measuring and understanding the supply structures in which they are enmeshed, it doesn't

throw much light upon how these decisions should or could be made. In fact Williamson's conception of 'sunk costs' based on previous transactions (or 'the way we have always done things') proposes that existing or prior inter-organisational arrangements will configure present and future ones. This is fine for stable and on-going transactions, whether internal or external to the firm, but doesn't really help when attempting significant and novel transformations or when responding to quickly changing conditions, such as the introduction of new technologies or changes in market demand. In cases such as these

"the decision on whether to do something new, demanded by the customer, cannot be based on what the firm has traditionally done" (Cox & Lamming, 1997:59)

This is especially pertinent given the wide ranging implications of transforming procurement from functional to strategic activities. Rather than being grounded in traditional activities, a more entrepreneurial model is required to aid decisions about large scale or significant reorganisation of the firm and its external relations. The focus can be shifted to consider whether the resources and knowledge a firm possesses can be combined to produce a competitive and sustainable position within a specific supply or value chain or network. This is not quite the same as just considering asset specificity, as a process or relationship which has had a large degree of resources directed at it (either through development of competencies in house, or investment in specific interfaces with other firms) might not offer competitive advantage within a specific or changing value chain. This reasoning equally applies to new products or services as well as existing ones.

Speckman et al (1999) helpfully provide a list of ten key principles of outsourcing and supplier management, which are useful in thinking about decisions to make or buy.

1. Integrate suppliers into the supply chain

We now know that this involves more than a series of one-off transactions if firms are to utilise their supplier networks effectively. Close collaboration and joint process design can "reduce cycle times, improve quality, achieve greater end users value and enhance two-way learning" (Speckman et al, 1999: 105). Honda incorporate their suppliers closely in new product design, and share innovations and R&D costs. They claim that in the design of the new Accord in 1998 supplier contributions saved around 20% of the traditional cost of development.

2. Share information

Substituting inventory for information more closely connects firms within the supply network, and allows each to understand more effectively the activities going on in other firms. This understanding can be used to find joint solutions to problems, show areas for improvements and highlight some of the potentially 'masked' inefficiencies discussed above. But there are other issues to consider, in terms of giving outside firms access to key internal competencies and processes. These sorts of relations have a high start up and maintenance costs, and can introduce undesired interdependencies. The key is perhaps to partner with firms with complementary, rather than competing skills and resources. But this leads to another crucial point:

3. Develop trust

In a business landscape where lean supply methods, best practice, and advanced IT solutions offer the potential for much closer inter-organisational collaboration, the main problem is not about the process, but rather about developing trust between partner firms. Trust is based on understanding (or having expectations about) how a partner will act, given certain types of information, resource, or opportunities. Although virtually impossible to define or measure, trust is a central prerequisite in working with other firms, outside of the functional and often problematic constricts of formalised contracts. The likely seat of such trust developing is through personal relationships, and through mutual adaptations over repeated interactions, in other words a long standing relationship. This can be facilitated with such simple measures as allocating time for managers from the involved parties to meet and discuss ways of working together, often in an informal way and building on personal ties. Supporting this are mutual or complementary goals.

4. Organise effectively to achieve alignment

This has intra as well as inter-firm dimensions. Often defined as 'silo thinking' many businesses are characterised by internal divisions and fiefdoms where control or authority are contested, and this could be a significant issue in the transformation of procurement from function to strategic player. In addition, the positions of buyer and seller can be misaligned, with both parties out to achieve the best 'deal' from their own perspectives. Effective supply management requires the expectations and understandings of all

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parties to be if not the same, then well aligned. One way to achieve this is for particular individuals to take on the coordination of the supply network as a whole, looking to find out the intentions of involved parties and to facilitate the alignment of expectations and coordination of goals – in essence to bring all firms round to sharing the same strategic vision for that network. Part of this is an organisation wide acknowledgement of procurement's role at a senior level and in the strategic positioning of the firm. In addition, training for procurement practitioners might be required to prepare them for this role.

5. Use commodity teams

This can partly address the 'silo' problem, as it advocates an enterprise-wide buying process. This effectively allocates resources to the integration both the procurement activities of the firm as a whole, and also of supply networks. The position is one of thinking about whole life cycles of products or services, and total system costs across the supply network. This allows the focus to be on the lowest total costs, rather than emphasising purchase cost alone. End users or customers can be brought into the team, to benefit from their knowledge and requirements, and to get them involved in supply coordination beyond simply purchasing goods or services.

6. Look globally for advantage – global sourcing

Global sourcing can be an important part of effective outsourcing and streamlining the value chain. Information and capital can easily be transferred around the globe, breaking the local or regional ties that have constrained inter-organisational collaboration

in the past. Factors to consider in global sourcing include purchase price, but also lead time delivery, technology, flexibility in response and schedule change and economic and political stability. For a global organisation, the supply network is part of its strategic infrastructure. Again this is not without challenges, especially in coordinating across highly dispersed supply networks.

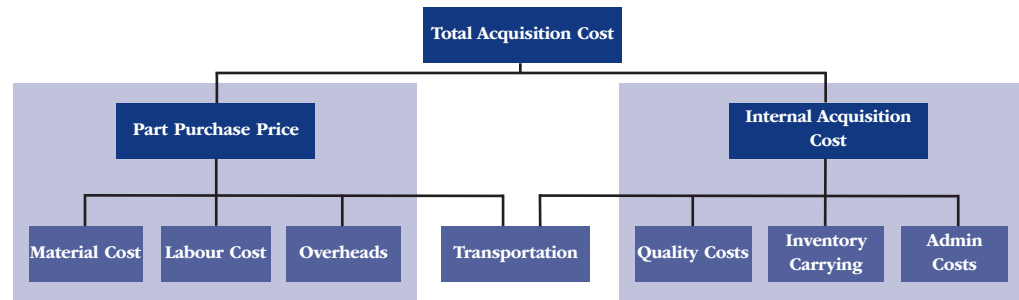
7. Focus on total costs

Taking advantage of changing markets requires more than just consideration of initial purchase price. Quality, delivery and service are increasingly important to end customers and users, and a source of competitive advantage for a particular firm, network or product. It is therefore often not enough to ensemble supply networks based only on the lowest priced suppliers today.

8. Rationalise the supply base

The rationalisation process involves simplifying the procurement process (bearing in mind the total acquisition cost shown in fig 5) and looking for ways to eliminate waste and redundancy in the supply network. The fundamental aspect of each supply network relationship is how it contributes value, perceived by end-customers. The question becomes one of who is best positioned within the network to perform particular activities. This is about understanding in detail the whole supply chain, and hence much research advocates moving towards dealing with a much smaller supply base, which allows more resources to be directed at improving the interfaces and understanding the activities of each one within the chain. Within this rationalisation process the interpersonal connections and trust developed is important in considering who to work closely with, and who to remove from the supply base:

Fig. 5. Total acquisition costs



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“strong relationships with a limited number of high quality suppliers position the enterprise to respond more quickly to market shifts and demands” (Spekman et al, 1999: 107)

9. Let the suppliers manage it

Closer ties within the supply base, and a higher degree of trust allow activities to be transferred to other firms within the network. This can include strategies such as allowing suppliers to perform their own quality control, hence removing this activity from the procuring firm, or allowing them to find innovative solutions to problems rather than developing and then prescribing supplier activities, processes or components.

10. Leverage technology

IT is a key enabler in building and improving strong inter-organisational relations. Information can be captured at a single point within the network and then shared in multiple contexts across partners. This can go beyond exchanges such as EDI (Electronic Data Interchange) or paperless invoicing (although these aren't without their own cost savings) to allow sharing of work-flow information between firms, and quick response times for adapting to changes or problems. But technology is only an enabler – it also requires the correct practices and ways of collaborating to support it.

These ten principles provide a detailed outline of the implications of a move towards strategic procurement, and the challenges of effective outsourcing and supplier management, as well as the potential benefits. They also show the interdependence between internal and external activities, and how managing both of these are central in allowing procurement to contribute effectively to the strategic direction and organisation of the firm.

*Taken from Procurement Specialisation white paper by Chris Harty
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