1.1 The development of sourcing

The development of the role of the purchasing function is sometimes described as a process in which the responsibility has gone from buying, via procurement to supply management. These various steps have meant an increase in the scope and impact of purchasing activities within the organization.

Purchasing as in ‘buying’ represents purchasing activities and responsibilities that deal with buying the goods and services needed and making sure that the basic function of the items bought is acquired at favourable conditions. This is a rather
narrow scope with a low degree of sophistication, the conceptual development of which mainly originated in the 1950s. The implementation on a broad scale of a more commercial orientation (initial steps to ‘play the market’) is normally dated a decade or so later.²

Purchasing as in ‘procurement’ deals with acquisitioning and optimizing the flow of materials (materials management, logistics), implying a widened role. It means (among other things) that not only price but also volumes and time aspects are being taken into account. The optimization aspect refers to the balancing act of buying large quantities to get a low price, but not too large to avoid costly stocks and not too small to avoid shortage and production downtime. The conceptual development of procurement is often dated to the 1960–70s, and its realization on a broad scale a decade later.

Purchasing as in ‘supply management’ increases the scope several steps further, and includes also the formation of supplier structures, the development of suppliers’ capabilities (resources, knowledge), improving administrative routines and so on. All this is done in order to reduce total cost – not only the price of the specific products bought, but also the costs of related activities like quality assurance and administration. In addition it includes efforts to stimulate the creation of new opportunities in terms of product and process innovation. The Japanese car and electronics industries’ way of organizing their supply structures is often referred to as a role model for this view on purchasing. Concepts like ‘multi-tiered supply chains’ and ‘early supplier involvement’ are important hallmarks of this view. Purchasing as in supply management could thus be defined as ‘managing the external resources of the firm, aimed at acquiring inputs at the most favourable conditions’. This definition acknowledges the possibility that a customer may be interested in more supplier inputs than just the ‘core’ goods and services, for example the knowledge embedded in the current and possible future offerings of the supplier. The definition also implies that purchasing may involve activities that are only indirectly concerned with (‘aimed at’) ‘obtaining’ inputs such as relationship building and supplier development programmes. The word ‘acquiring’ implies that the inputs may not only be bought, but could also be leased, rented, borrowed or traded (e.g. as in the case of counter-trade).³

There are several reasons behind this gradual increase in the importance and scope of the purchasing function. Much is due to the ongoing trend towards specialization, meaning that every organization specializes in an increasingly smaller range of value added in its production process (be it manufacturing or services production processes), which leads to an increased share of externally acquired goods and services. Nowadays, purchasing-to-sales ratios in general are in the range of 30–60% for service organizations, 50–70% for manufacturing industries and 80–95% for retailing firms – and many organizations are seeing a further rise in this percentage. Not only are organizations increasingly outsourcing noncore activities, for example in the form of contract manufacturing, but this frequently takes the form of offshoring – essentially shifting activities to lower-wage countries such as India and China.⁴

There are also other reasons behind the pattern of change described, including the development of new managerial principles and concepts such as total quality
management (TQM), just-in-time (JIT), efficient consumer response (ECR) and so forth, often enabled by new information and communications technologies (ICT). These concepts naturally lead to a strong focus on the need to consider interorganizational relations in efforts to improve efficiency and effectiveness in organizations.

As part of the development towards this more ‘holistic’ view of purchasing, there has been an ongoing process of increasing sophistication in the concepts, techniques and human resources involved. These techniques and concepts have been applied to varying degrees, related not only to the type of organization, but also to the particular goods and services bought within each organization.

The approach described in Figures 1.1 and 1.2 illustrates very well a ‘holistic’ approach towards purchasing. This approach was introduced in the late 1990s by Professor Monczka and his team from Michigan State University and was based on the insights from the Global Procurement and Supply Chain Benchmark initiative. This integral framework sketches the route to purchasing excellence and includes eight key strategic processes and six strategic enablers. To run a sophisticated purchasing and supply management operation, a company should continually address the basic strategic questions related to purchasing and supply chain operations. First, it should consider whether to outsource specific processes or not, or whether it should insource processes presently performed by outside suppliers. Once that decision has been made to outsource, or keep as outsourced, the next step is to develop a commodity strategy for each specific item.

The subsequent steps, as illustrated in Figure 1.1, are to establish and leverage a world-class supply base, to develop and manage supplier relationships, then, to integrate suppliers into new product development processes and to integrate

![INTEGRATED, ALIGNED AND GLOBAL](image-url)

**FIGURE 1.1** Purchasing and supply chain world-class excellence – strategic processes.

them into order fulfilment processes. In order to keep improving, the company should opt for supplier development as well as successively manage costs across the supply chain.

These processes cannot be performed without relevant capabilities, or *enablers*. Therefore a second cycle is introduced. The first step is to introduce globally integrated and aligned purchasing and supply chain strategies and plans. This is followed by steps to develop proper organization and teaming strategies, deploying globalization and developing purchasing and supply chain measurements. The final two steps include to develop and implement enabling IS/IT systems and to establish human resource development and training. This way, by applying the two connected cycles, a company will manage to create an integrated and aligned as well as global operation.

These areas of capability building largely coincide with the areas of change that we discuss in this book. However, here they are not framed as areas of change in relation to processes of strategic change. They are merely framed as factors that need to be shaped and fitted to the operation in order to enable world-class operations. We agree, nevertheless, with this overall representation of purchasing and supply management and conclude that there is always a need for change in companies, otherwise they will be unable to stay competitive. All changes need not be of a strategic character, though.

We will be emphasizing that given the inherent cross-functional nature of the purchasing process, there are many actors inside a firm who act as ‘part-time purchasers’. Still, the purchasing specialists themselves have experienced an increase in qualifications and recognition. This has been reflected in, among other things, an upgrade of purchasing in the corporate hierarchy. Especially in large firms, we now frequently find titles such as purchasing director, vice-president of purchasing or chief purchasing/procurement officer. Gartner expects that by the end of 2008, at least 50% of all Global 2000 firms will have a
CPO in place who is directly reporting to the CEO. Also from job descriptions and recruitment processes, it is easy to infer that the profession has advanced substantially.

In this short description of the development of the purchasing function, one can also recognize an increased emphasis on nonoperational activities. Within the overall purchasing function, as for other business functions, a distinction can be made between operational, tactical and strategic tasks.

In this book from now on, we primarily use the term sourcing rather than purchasing, to reflect our emphasis on strategic and tactical purchasing activities. Sourcing essentially is a cross-functional process, aimed at managing, developing and integrating with supplier capabilities to achieve a competitive advantage. This does not only involve externally oriented activities, such as supplier performance measurement and market research, but also (primarily) internally oriented activities such as the development of organizational mechanisms like cross-functional buying teams, and human resource development. We sometimes use purchasing and supply management as a synonym for sourcing, also to reflect this combination of internally and externally oriented activities, which obviously in reality will be very closely connected to each other.

Strategic sourcing has also become quite a popular term among management consultants such as McKinsey, AT Kearney, Boston Consulting Group, Booz Allen & Hamilton, PricewaterhouseCoopers and OC&C.

Given the substantial challenges in moving from one type of view or orientation on purchasing to the next, many organizations and sourcing managers have been facing numerous issues regarding the creation and management of change. This book deals primarily with such change issues – not only in terms of the areas of change, but also the methods of change.

Before we continue to discuss the objectives and contents of the book further, let us consider the example of one of the world’s largest firms in the computer industry in order to get a first impression of the kind of transitions or transformations we will be looking at.

1.2 An illustration: sourcing transformation at IBM

IBM’s sourcing transformation story begins in the early 1990s. IBM suffered from shrinking earnings and cash flows. In 1993, earnings and cash flow went negative and the stock price decreased to US $41, when it was US $117 in 1990. The fate of the entire company was at stake.

This ‘near-death experience’ acted as a catalyst for change. IBM embarked on a transformation of all of its key business processes, resulting in many role changes. Sourcing, or ‘procurement’ as it is usually referred to within IBM, was recognized as a key part of the overall IBM corporate transformation, sponsored by the chief financial officer (CFO) and chief executive officer (CEO). Procurement was becoming increasingly important as IBM’s business model changed from being a hardware manufacturer towards being a service provider. Today, almost 50% of
each revenue dollar is converted to supplier spend and purchasing makes up 72% of the costs of goods sold. Procurement was reaffirmed by the board as the only part of the organization allowed to commit funds for IBM (delegation of authority). The goal was to create a strategic reorientation with sustained competitive advantage. This, however, was not an easy target. IBM faced some serious gaps in procurement performance. The procurement organization was fragmented, end-users were dissatisfied with procurement performance and there was a lot of ‘maverick buying’ (buying without formal approval) going on. People working within procurement lacked real sourcing expertise and mainly had an operational focus. Processes were inconsistent, paper intensive and slow. For example, it took 30 days to process an order and about 6–12 days to process a contract.

It was IBM’s strategy to move from a short-term to a strategic focus, which would drive long-term sustained results. To achieve and sustain procurement effectiveness, it invested in four major areas: strategy and governance, processes, technology, and people and organization. Also, IBM established a set of procurement strategic imperatives that have remained remarkably consistent over the years:

1. Perpetually drive quality improvements from suppliers.
2. Continually deliver lowest cost and greatest competitive advantage.
3. Establish premier supplier relationships that give IBM access to the latest technology, supply continuity and speed to market.
4. Grow e-procurement leadership.
5. Continually improve client perception of our value through increased influence and customer service.
6. Attract, motivate and retain the best talent within procurement.

IBM adopted a new leadership model to drive the transformation. The CFO established a global procurement office headed by a chief procurement officer (CPO) to create an organization with executive standing. The CPO was given sole responsibility, by the board of directors, for procurement. The global procurement organization consists of the global procurement staff, the global procurement services group (e.g. industry intelligence, market analysis, logistics support), the procurement executives and the procurement engineering group (e.g. early supplier involvement, emerging supplier development, technological quality). In 2002, there were more than 3700 full-time employees working in procurement in more than 70 countries and over 300 procurement resident locations – compared to 3300 employees in 1995. More importantly, the percentage of people within this group that was working on strategic issues had risen from 10% to 75% in this period!

The global commodity councils are at the core of IBM’s leadership structure. There are 13 nonproduction councils (e.g. travel, marketing, telecom) and 18 production councils (e.g. LCD, Cables and Connectors, OEM and Contract Manufacturing). The permanent commodity councils perform strategic activities associated with procurement. They have the following responsibilities:

- Develop commodity strategies and implement plans.
- Gather client requirements and demand management data.
- Develop technical roadmaps.
- Provide market intelligence.
- Reduce costs and improve competitive advantage.
- Lead cross-functional evaluation of new suppliers, services and parts.
- Negotiate contracts and manage supplier relationships.
- Communicate contract guidelines to all affected parties.
- Resolve major supplier performance issues.

A critical first step performed by the councils was to rationalize IBM’s global supply base. They also implemented a standardized contracting model across the enterprise to simplify the process. From a situation in which it took six months or longer to implement a 40+-page contract, it takes 30 days or less to implement the six-page standard master contract today.

In order to measure procurement’s contribution to the corporation, IBM implemented a Procurement Competitive Advantage (PCA) measure. PCA measures the difference in actual price change for IBM versus industry price changes and it shows IBM’s buying performance relative to the marketplace. For example, a 15% IBM price reduction in a given commodity versus an industry price reduction of 10% would yield a positive 5% PCA measurement. IBM uses multiple measures along with market intelligence to test the effectiveness of its buying.

Apart from the issues discussed so far, IBM invested heavily in its people to ensure that they have the necessary skills to implement the procurement strategy. A well-structured set of courses was designed for people in procurement:

- Basic core courses for the essential procurement skills.
- Intermediate courses for more specific knowledge like strategic outsourcing.
- Advanced courses in, among other things, strategic cost management, strategic supplier relationship management and strategy development.

In order to deliver these courses efficiently to a global procurement population, IBM uses e-learning techniques.

IBM went through multiple phases while transforming its procurement practices.

**Phase 1 – Foundation (1994–95)**

- IBM leverage, delegation decision, council structure, enforcement.
- Strategic sourcing, single management system.
- Skills, learning, roles, responsibilities, leadership, communications.
- Data simplification, procurement-to-payment linkage.

**Phase 2 – Transforming the enterprise (1996–97)**

- Link to development and employees, competitiveness measures, joint scorecard.
- Common processes.
• One procurement team, new roles: influence bid teams.
• Transaction engine, global workspace, global data management.


• Quick wins, fix problems, create value, build for future.
• Supplier readiness, supplier capability, hands-free process, eliminate paper.
• E-care, e-learning.
• E-procurement, web exploitation, point solutions.

Phase 4 – On demand (2003–?)

• On-demand global supply chain, vertical to horizontal, industry SCM (supply chain management) leadership.
• E2E process execution (direct electronic links between the various actors in the supply chain), supply organization, demand conditioning, real-time collaboration.
• One ISC (integrated supply chain) community, broad skills development.
• Inter/intra-enterprise integration, broader/deeper e-procurement exploitation, seamless data management.

The results of the transformation have been tangible and allow IBM to continue investing in procurement (see Table 1.1).

IBM is widely recognized for its efforts in transforming procurement. It was the 1999 winner of the *Purchasing* magazine Medal of Professional Excellence and the MIT Sloan School award for Transformation of Procurement and Payables. Also, a large number of companies (more than 50 a year) come to visit IBM to benchmark procurement practices. IBM is now regarded as a world-class standard in sourcing.

IBM learned some valuable lessons that might be worthwhile to look at. When transforming procurement one should never underestimate the importance of:

• Managing organizational change.
• Inducing the right behaviour.

<table>
<thead>
<tr>
<th>TABLE 1.1</th>
<th>Results of the sourcing transformation at IBM</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1990s</td>
</tr>
<tr>
<td>Sourcing expertise in place</td>
<td>&lt;10%</td>
</tr>
<tr>
<td>Electronic catalogues</td>
<td>0</td>
</tr>
<tr>
<td>Maverick buying</td>
<td>&gt;35%</td>
</tr>
<tr>
<td>End-user satisfaction</td>
<td>40%</td>
</tr>
<tr>
<td>Acceptable business controls</td>
<td>55%</td>
</tr>
<tr>
<td>E-enabled suppliers</td>
<td>&lt;500</td>
</tr>
<tr>
<td>Electronic purchases</td>
<td>&lt;20%</td>
</tr>
<tr>
<td>Purchase order cycle time</td>
<td>30 days</td>
</tr>
</tbody>
</table>
• Making significant investments.
• Taking some risks.
• Leadership.
• Innovating constantly.
• Enlisting corporate support.
• Involving all stakeholders.
• Getting help.

Many of these topics and other issues in developing sourcing as an organizational capability will return in the following chapters.

1.3 Contents of the book

In this book, we explore the topic of strategic change in sourcing. The basic notion is that it is quite commonly known what potentials and options there are to improve the contributions of the competitiveness of the organization – but how can it be done? Many sourcing executives sigh: ‘We all know what should be done, but how can we make it happen?’ It is our ambition that this book gives at least a useful overview of the potential areas and instruments of change, combined with some practical illustrations and recommendations. In the end, however, it is obviously individual organizations and managers that ‘make it happen’.

The book is divided into three main parts: Part I – Introduction, Part II – Areas and Instruments of Change, and Part III – Illustrations (see Figure 1.3). In Part I, the following chapter, Exploring Change Issues in Strategic Sourcing, expands on the introduction in the current chapter. Among other things, it discusses a model of various maturity stages in sourcing, which will return in following chapters. Chapter 3, the final chapter of the Introduction part, focuses on a number of general aspects of strategic change. Henrik Agndal, Björn Axelsson and Leif Melin provide an overview of the most important issues in the field and introduce us to the present thinking in the area of strategic change and its management. They also provide some implications of their overview for strategic change in purchasing.

In Part II of the book, we turn to specific areas and instruments of change within sourcing. Chapter 4 deals with supplier relations and supplier networks, and the creation of change within those. Anna Dubois and Finn Wynstra discuss issues like transactional vs relational buying, variety in supplier relations, different patterns in changing supplier relations and the role of sourcing as an interface between internal and external parties. In Chapter 5, Frank Rozemeijer and Finn Wynstra take changes in organizational design and organizing processes as their point of departure. In Chapter 6, the creation of change through changes in leadership, culture and values is discussed by Ethel Brundin, Leif Melin and Björn Axelsson. This chapter has a very strong focus on the human resources side of change management.

Chapter 7, by Björn Axelsson, Pieter Bouwmans, Frank Rozemeijer and Finn Wynstra, deals with another aspect of human resources: management and improvement of knowledge, skills and capabilities. In Chapter 8, Jens Hultman and Björn Axelsson discuss strategic change originating from the exploitation of (new) information
FIGURE 1.3 Overview of the book.

and communications technology. Chapter 9 looks at performance measurement and management accounting as enablers of change within sourcing. Björn Axelsson, Finn Wynstra and Frank Rozemeijer discuss various concepts and tools and their possible effects. Finally, Chapter 10 concludes Part II with a discussion of the role of individuals in strategic change processes, in particular related to sourcing. Sicco Santema, Marc Reunis and Frank Rozemeijer deal with issues such as how job characteristics and individual roles may be affected by various changes within sourcing, and the attitudes of individuals towards change.

Part III comprises a number of illustrations of specific change or transformation efforts, mainly from different worldwide-operating European companies. In Chapter 11, Arjan van Weele surveys several experiences of change processes in the Dutch purchasing community, specifically in relation to centralization vs decentralization efforts. In Chapter 12, Björn Axelsson describes a rather ambitious case study of the construction company NCC, in which the change agents have combined several of the areas and creators of change discussed in the previous chapters. In Chapter 13, Fraser Johnson and Mike Leenders analyse the role of purchasing in a dramatic corporate turnaround at Thomson. Chapter 14, finally,
looks at one of the most widespread ‘geographical’ trends in sourcing nowadays: sourcing in China, in particular the experience of Ericsson. Tony Fang and Björn Axelsson look at the patterns, the challenges that buying firms are facing, and the ways to meet those challenges.

Last, in Chapter 15, Björn Axelsson, Frank Rozemeijer and Finn Wynstra provide a synthesis of the entire book and a discussion of what is possibly ahead.

Notes and references


2 We primarily refer to development in regions like the EU and North America.


4 Offshoring and its effects on the economy was one of the central issues in the 2004 US presidential elections. See also the book by Buchholz, T.G. (2004) Bringing the Jobs Home: How the Left Created the Outsourcing Crisis – And How We Can Fix It, Penguin: Harmondsworth.


6 See also Van Weele (2005) opere citato, Chapter 1. Van Weele defines sourcing to include processes like supplier selection and contracting, but to exclude the prior step of specification setting. We, however, include this step also in sourcing.


