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STRATEGIC VIEW

Why center-led procurement is gaining in purchasing popularity

[Editor's note: From time-to-time, PURCHASING magazine presents the viewpoint of procurement professionals on topics of strategic importance to purchasing executives. If you have a strategic purchasing issue you would like to address, please contact Editor-in-Chief Mike Verespej at michael.verespej@reedbusiness.com]

In his book, "Who Says Elephants Can't Dance," former IBM CEO Lou Gerstner voiced what purchasing professionals have known for decades when he cited centralized purchasing as one of the first things a company should do to save money. And indeed, consolidating common purchases across the enterprise has provided the first great wave of procurement savings.

But although there are still billions of dollars in savings to be captured from better execution of centralized purchasing, leading purchasing organizations are also beginning to see the limits of pure centralization and are forging ahead to explore new frontiers.

Center-Led Procurement (CLP) is generating interest among procurement professionals because it offers the opportunity to provide the next great wave of savings.

However, purchasing organizations interested in CLP need to make sure that they don't underestimate the challenges involved. As they consider CLP for their organizations, they need to understand the policies, operating models and measurements needed to make it a reality.



Dave Stephens

Limits of centralized procurement

In complex, distributed enterprises, complete centralization is not always practical or even desirable. For example, central purchasing organizations are sometimes unable to outperform local procurement buyers who have extensive knowledge of local supply markets and consumption patterns. And, of course, certain goods and service categories—snow removal being the classic example—are simply not well suited to centralized purchasing. In other instances, organizational politics, tax considerations or regulatory requirements often require local procurement of some categories that logically could be centrally purchased.

Many purchasing organizations have experimented with permutations of centralized and decentralized purchasing. After a few swings of the pendulum between these poles and—after experiments with other hybrid models—many procurement leaders have embraced Center-Led Procurement (CLP) as the synthesis of opposites.

Why? CLP extends the reach of purchasing to lead and improve procurement processes regardless of whether they are executed centrally or locally. In addition, it gives the central purchasing organization influence over distributed purchasing process by allowing them to promote best practices into spend areas that they don't directly control.

But like the old Wall Street admonition, "buy low, sell high", instituting CLP is easier said than done. Maximizing

savings from CLP requires purchasing leaders to think in new ways in three key areas: policy, operating models and measurement.

What is Center-Led Procurement?

Center-Led Procurement (CLP) is a procurement model that suits the needs of the business unit and the special characteristics of specific goods and service categories. CLP applies different purchasing models—including centralized shared-service, decentralized and hybrid buying—depending on what is being bought, who needs it, and where it will be used.

CLP decouples the physical and logical locations of procurement activities. Buying is executed where and how it makes the most sense, while the purchasing department contributes structure, expertise and measurement to the process. Major manufacturing components such as drivetrains for automobiles are usually centrally sourced by purchasing. On the other hand, snow removal services are impossible to source on a strictly central basis because supply markets are highly localized. However, central purchasing organizations can still save money on snow removal by providing business units with best practices for contracting these services in local markets.

The policy challenge

Appropriate policies and the mechanisms for creating them are even more crucial to success in CLP than in centralized procurement. While a completely centralized purchasing organization could (at least in theory)

declare that all purchases must pass through its gates, CLP requires a more flexible approach. That is, the purchasing organization develops policies that structure and guide all buying, while leveraging the best expertise in the enterprise for each category.

Ironically, this may mean that purchasing policy is determined by far-flung and sometimes autonomous business units. But procurement organizations must realistically assess their political strength in the organization, because they risk damaging their own credibility if they unilaterally dictate policies that business units ignore. Instead, smart purchasing leaders gain influence by building cross-functional category councils with representation from all geographies, functions (e.g. finance) and perhaps even suppliers. This trade-off ultimately leads to greater measurable savings because policies that obtain business unit buy-in receive much better compliance.

What's more, if you attempt to write specific policies for every corner case, you will quickly pass the point of diminishing returns. It is better to focus on the details of the top categories and the generalities of the less important ones. Because it isn't

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practical to write explicit policy guidelines covering all situations, purchasing should lead the creation of category councils for setting policy for only 10-20 most strategic categories. Purchasing's contribution to these exercises include exposing and documenting hidden cost and savings drivers. As much as possible, make business leaders responsible for enforcement and manage the most egregious violations by exception.

Implementing and enforcing policy in CLP is significantly more complex than in purely centralized procurement, but they can help enforce it in distributed transactions. Automating routine transactions can also give purchasing professionals more time to manage exceptions and conduct higher-level analysis such as contract coverage and compliance.

The operating model challenge

CLP is not itself an operating model, but rather a framework for applying multiple operating models such as centralized, transfer, central sourcing and decentralized sourcing. Because CLP applies any and all of these models rather than advocating a particular one, it demands flexibility of both your organization and your systems.

The key challenge is learning how to guide transactions the purchasing organization does not directly control. This differs from the coercive power to approve or reject and requires purchasing to build new relationships and acquire new kinds of skills including:

- Design and engineering to understand the contribution of innovation to price/performance.
- IT to understand the value of technically aggressive suppliers and improve internal systems.
- Interpersonal skills to influence others and sell procurement initiatives.

Mixing operating models also creates challenges with respect to information systems. Procurement automation must be flexible enough to implement different models based on any sliced and diced combination of category and organizational entity. For example, if a particular component is purchased centrally as a rule—but is sourced locally for a subsidiary in China, CLP requires intelligent application of purchasing rules from central agreements as well as local sourcing for China.

One less obvious benefit of mixing and matching purchasing models is that you can decouple the physical and logical location of purchases and put individual parts of the process anywhere. One example of this is when a company moves low value, low skill purchasing functions to lower cost locations in order to save money.

However as much—if not more—can come from doing the reverse and moving high-value activities (e.g. best practices, Request For Quote—RFQ, contract templates, and research on categories) to locations where the highest skills are available.

The measurement challenge

CLP also requires new forms of measurement suited to purchasing's expanded oversight of traditionally decentralized categories. Measuring the savings from centralized purchasing is hard enough, but to show success in CLP, purchasing must face the much harder challenge of documenting savings in spend it does not directly control. So taking immediate baseline measurements and showing rapid improvement upon them is essential. CLP also inevitably imposes new processes—and often new suppliers—on business units, which will push back unless purchasing shows evidence to senior management that the results are worthwhile.

Once initial credibility for CLP is established, the focus of measurement shifts. Aggregation of purchasing order data for consolidation opportunities remains important, but more strategic measurements come to the fore. Purchasing leaders measure supplier performance and business units commit to following policy, contract compliance, regulatory compliance and more. With so many metrics to follow, purchasing professionals must be able to view up-to-date information themselves at any time rather than waiting for IT or external consultants to prepare reports.

Though it's easy to tout the importance of measurement, most organizations find that poor data quality makes meaningful measurement very difficult. Purchasing must therefore take the lead in maintaining data quality and educating the entire organization on why up-to-date quality data is essential. Despite best efforts to enlist local cooperation, purchasing must take the lead in committing dollars and heads to this effort. Local IT departments are unlikely to have the resources, focus or political will to fully support this corporate-level objective.

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