

Unraveling strategic purchasing

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Summary

After forty years of purchasing literature, strategic purchasing still is not well-defined. Using insights from strategic management and purchasing management, this paper defines *strategic purchasing* (from a process perspective) as the coherent set of activities within the purchasing function that contributes to the development and implementation of the strategy of an organization, and therefore contributes to creating and maintaining sustainable competitive advantage (SCA). Based on this definition, this paper describes and illustrates the most important activities of strategic purchasing.

Key words

Strategic purchasing, sustainable competitive advantage

Educator & practitioner summary

Tactical and operational purchasing have already been defined well, implying that it is clear what activities it encompasses. This paper unravels strategic purchasing by describing its activities, aiming to provide educators and practitioners with a concrete and defensible definition of strategic purchasing.

Introduction

In the field of purchasing management, the word *strategic* is often abused. It is frequently used to underscore the importance of - for example - a commodity or process, and does rarely

relate to the strategy of an organization. A clear example is the use of the word strategic in the term *strategic commodities*, defined as commodities with a high supply risk and a high impact on profit according to Kraljic (1983). Of course, these commodities are important, but - in general - they do not have anything to do with the strategy of an organization. Another example is provided by Monczka (2005), who distinguishes eight *strategic processes*. Again, these processes may be very important for an organization, but - in general - do not relate to its strategy. There is an extensive collection of other examples that could be mentioned over here (e.g. *strategic purchasing* in (Carter, 2000)) to illustrate that the word strategic in the field of purchasing management is often used without a strategic meaning.

Still, it could be very valuable to have a clear definition of strategic purchasing (and related terms like strategic processes, strategic suppliers and strategic commodities). In order to make this clear, we first have to look at tactical and operational purchasing and their impact on an organization. Tactical and operational purchasing are already well-defined by van Weele (2002). Tactical purchasing is defined as the set of activities that lead to contracts (specify, select, contract). Operational purchasing is defined as the set of activities that lead to orders, receipts and invoices (order, monitor, after care). Although it has never been formally proven, it is generally accepted in the field of purchasing management that tactical purchasing influences costs and value more than operational purchasing. During tactical purchasing major decisions are made about product specification and supplier (market) selection. These decisions have a large impact on costs. During operational purchasing minor decisions about for example the order quantity are made. These decisions only slightly affect costs. But if it is generally accepted that tactical purchasing influences costs and value more than operational purchasing, we can also argue that strategic purchasing should influence costs and value more than tactical purchasing. This is visualized in figure 1. With a clear description of strategic purchasing, we could open a new set of decisions to influence costs and value.

Insert figure 1 here: Influence on costs and value

This paper aims to clearly define strategic purchasing, by using insights of strategic management and purchasing management. In the first section of this paper, we focus on the field of strategic management. Three important schools of thought are summarized in order to see whether these schools offer insights for describing strategic purchasing. In the second section we assess existing purchasing literature in order to identify insights for describing strategic purchasing. Based on these insights, we propose a definition of strategic purchasing in the third section of this paper. This definition is elaborated and illustrated in the third section. This fourth and final section of this paper summarizes some managerial implications and directions for further research.

Insights within the field of strategic management

In the field of strategic management, strategy (unfortunately) has several definitions. Most definitions make clear that strategy is about the direction of an organization on the long term: how must an organization look like in a couple of years? The development and implementation of a strategy is aimed at creating and maintaining sustainable competitive advantage (SCA) (Mintzberg, 1998) (Dyer, 2000). So, strategy is aiming at SCA. An organization is said to have competitive advantage (CA) if this organization is implementing a strategy that creates value and is not being implemented by (potential) competitors at the

same time (Barney, 1991). In other words, an organization has CA, if this organization has something that (potential) competitors do not have and that is valued by customers. This CA is sustainable if it lasts for a certain time period or holds after attempts of competitors to duplicate it failed (Barney, 1991). In turn, SCA leads to above normal financial performance.

Three important schools of thought within the field of strategic management are:

1. Industry Structure View (Porter, 1980)
2. Resource Based View (Prahalad, 1990)
3. Relational View (Dyer, 2000).

These three schools are briefly summarized below.

Industry Structure View

The Industry Structure View focuses on the question what an organization should and should not do itself in order to create and maintain SCA. For answering this question, the Industry Structure View looks at the *five forces* that are generally present in each industry, namely:

1. threat of new entrants
2. negotiation power of customers
3. negotiation power of suppliers
4. threat of substitution
5. competition of existing organization.

Once the question above has been answered by assessing these five forces, the objectives of this organization are clear. Subsequently, processes, systems and organizational structure should all be directed to and aligned with these objectives, which should ultimately lead to SCA.

Resource Based View

The Resource Based View does not use the outside-in approach of the Industry Structure View, but uses an inside-out approach. This view focuses on the *competences* that are currently present in an organization. Competences that meet a limited number of specific criteria (like contributing to value as perceived by customers and hard to imitate) are called core competences. Processes that are built upon these core competences are called core processes. The core processes should be executed by the organization itself. All other competences are called non-core competences and the associated non-core processes should preferably be outsourced. By organizing processes in this way, SCA can be created and maintained.

Unfortunately, the formal criteria that determine whether a competence of an organization is core or non-core are not easy to apply in practice. A more practical criterion is whether a supplier exists that is executing the processes related to this competence better than this organization (Ramsay, 2001) (Humphreys, 2000). If such a supplier exists, the competence is a non-core competence implying that the associated processes should be outsourced. This criterion is clearly purchasing oriented and could possibly be used in defining strategic purchasing.

Relational View

The Relational View is a school of thought that was recently developed by – amongst other – Dyer (2000). The central thought in this school is that relationships with other organizations

(like suppliers) can help an organization to create and maintain SCA. The Relational View supposes that competition between organizations evolves to competition between networks of organizations, called *extended enterprises*. Strategy development does not take place at the level of individual organizations, but at the level of these extended enterprises in order to create and maintain collaborative SCA. Good examples of extended enterprises can be found in the automotive industry (e.g. Toyota). It is clear that this school of thought provides valuable insights for defining strategic purchasing, since suppliers can be the source of SCA.

Insights within the field of purchasing management

Purchasing literature has been assessed in order to get insights for describing strategic purchasing. It turned out that - so far - this topic has generated only a small number of papers. This is also confirmed by an analysis of Carter (2003) who has categorized all publications in the Journal of Supply Chain Management and came to the conclusion that strategic purchasing is not a topic that is frequently addressed. Cousins (2003) and Chen (2004) confirm the value of having a clear description of strategic purchasing, but also conclude that this topic is not addressed often.

Two well-known publications that do address strategic purchasing have been written by Ramsay (2001) and Mol (2003). Ramsay (2001) approaches strategy from the Resource Based View and examines the contribution that the purchasing function can deliver to SCA. He concludes that the purchasing function can indeed contribute to profits and even to above normal profits, but this does not have to be a contribution to SCA. And only if the purchasing function adds to SCA, purchasing is truly strategic. However, the purchasing function is responsible for the processes that are built upon non-core competences. These non-core processes have to be outsourced according to the Resource Based View. Ramsay concludes that these non-core processes do - in general - not contribute to SCA, thus pointing at purchasing's non-strategic nature. There are only a small number of exceptions in which non-core processes are executed by suppliers, who do contribute to SCA. Only in these cases, purchasing is strategic, according to Ramsay (2001). This offers insight for defining strategic purchasing: isolating suppliers that contribute to SCA from competitors can be seen as an activity of strategic purchasing. Non-isolation would imply that these suppliers can offer the same goods and services to competitors, which would take away the CA that the organization gets from these suppliers.

As mentioned before, determining which competences are core and which are non-core, is crucial in the Resource Based View. Analyzing supplier markets in order to find out whether associated processes are executed better by a supplier, can be a way to distinguish between core and non-core competences, according to Ramsay (2001). Given the direct relation between this activity and SCA, it is obvious that this represents a strategic activity. Moreover, the purchasing function is probably the most logical function to execute this activity, meaning that this activity can be seen as one of the activities that belong to strategic purchasing.

Mol (2003) uses - amongst other - the Industry Structure View and states that the purchasing function can affect three of the five forces mentioned earlier. And since it affects at least one force, Mol (2003) argues that it is of strategic importance. In addition, Mol (2003) uses the phrases 'of strategic importance' and 'strategic purchasing' as if they were synonymous. That would imply that an activity belongs to strategic purchasing, if this activity affects at least one

of the five forces. This would mean that a lot of (even trivial) activities would belong to strategic purchasing. The conclusion must be that 'strategic purchasing' probably is not synonymous with 'of strategic importance' and that Mol (2003) has not really defined strategic purchasing. He only indicates that activities related to outsourcing decision-making could be seen as activities belonging to strategic purchasing.

Of course, more publications that address strategic purchasing have been written. In this paper we only discuss two recent publications, written by Cousins (2003) and Chen (2004). Cousins (2003) does not specifically mention strategic purchasing, but he addresses strategic supply. He distinguishes six aspects that play an important role within strategic supply:

- corporate & supply strategy
- organization structure
- portfolio of relationships
- cost/benefit analysis
- skills & competences
- performance measures.

Unfortunately, these aspects are not thoroughly described, which makes it hard to relate them to strategic purchasing. Based on the descriptions provided by Cousins (2003), (many of) these aspects might also play an important role within tactical and operational purchasing.

Chen (2004) has tested seven hypotheses relating strategic purchasing with - amongst other - a limited number of suppliers, open communication, long term relationships. Strategic purchasing is operationalized by a number of items, namely:

- the extent to which purchasing participates in the strategic planning process of the organization
- the extent to which the purchasing function has knowledge of the strategic objectives of the organization
- the extent to which purchasing performance is measured in terms of contributions to the success of the organization
- the extent to which the development of purchasing staff is focused on elements of the strategy
- the extent to which the purchasing department plays an integrating role in the purchasing function.

These items might indeed also provide valuable insights in defining strategic purchasing.

Definition of strategic purchasing

Combining the insights of strategic management and purchasing management, strategic purchasing can be defined as:

the coherent set of activities within the purchasing function that contributes to the development and implementation of the strategy of an organization, and therefore also contributes to creating and maintaining sustainable competitive advantage (SCA).

Based on this definition, activities that are part of the strategic purchasing process can be deduced. Although more activities can probably be deduced, at least the following activities are part of strategic purchasing:

- Co-establishing the core and non-core processes of an organization. By analyzing current and potential supplier markets and by assessing suppliers, core processes of an organization can be identified (Ramsay, 2001). Alternatively, it is also possible to apply the formal criteria to identify core and non-core processes, but - as mentioned before - these formal criteria are hard to apply in practice.
- Determining the desired organization including its relationships with suppliers (supplier relationship design (SRD)). According to the Resource Based View, core processes should be executed by the organization itself and non-core processes should be outsourced. However, it may not always be possible to outsource a non-core process. Determining the desired organization encompasses developing business cases that make clear what processes should and should not be outsourced (Humphreys, 2000) (Moody, 2001) (Cousins, 2003). When a decision has been made to outsource a process, the organization should also determine whether a supplier is sought that has to contribute to the SCA of the organization or not. A supplier that has to contribute to SCA is called a *strategic (or dependent) supplier*. A supplier that does not have to contribute to SCA is called a *non-strategic (or independent) supplier*. The organization itself and its strategic suppliers are called the *extended enterprise* (Dyer, 2000).
- Selecting and contracting strategic suppliers. Suppliers have to be selected and contracted for those processes that have to be outsourced to strategic suppliers. This activity is complex and its results are dependent on the competence of the organization to identify potential strategic suppliers and estimate their possible contribution to SCA. Of course, during this activity the organization can make use of the suppliers that were already identified during the supplier markets analyses of the first activity.
- Developing and managing (the network of) strategic suppliers in order to assure that they actually contribute to the SCA. This includes isolating strategic suppliers in order to prevent them from delivering the same goods and services to competitors, which would nullify their contribution to SCA (Ramsay, 2001).
- Operational buying at strategic suppliers. Maybe this sounds counterintuitive, but this operational activity is absolutely strategic. It is not only important to develop a strategy that may contribute to SCA, but it is just as or even more important to implement such a strategy in an appropriate way. Operational buying at strategic suppliers is an activity where the strategy developed is actually implemented and where SCA is created on a daily basis.

The activities of strategic purchasing are visualized in figure 2 (the light grey part).

Insert figure 2 here: Activities of strategic purchasing

Some remarks can be made in order to further clarify the definition of strategic purchasing.

Firstly, selecting and contracting as well as operational buying at independent suppliers does not belong to strategic purchasing. The reasoning is straightforward: independent suppliers do not contribute to SCA and therefore all activities that focus on independent suppliers are non-strategic. This also means that developing purchasing strategies (briefly defined as how suppliers should be treated, assessed and selected) for selecting and contracting independent suppliers is not an activity that belongs to strategic purchasing. As soon as strategic suppliers are involved, these activities belong to strategic purchasing. If this is compared to the purchasing process model of van Weele (2002), the conclusion is that this model defines tactical and operational purchasing for independent suppliers (the dark grey part in figure 2)

as well as a part of strategic purchasing, namely the third and fifth activity listed above, for strategic suppliers.

Secondly, outsourcing is not always strategic, although many practitioners seem to think so. In its core, outsourcing is nothing else than tactical purchasing: specify what is needed, select an appropriate supplier and contract that supplier. Of course, there are some differences. The main difference between outsourcing and tactical purchasing is that in the case of outsourcing, the specification of what is needed also specifies that the supplier that is sought must also take over existing resources (people, systems, et cetera) from the organization. Related to what has already been mentioned, only outsourcing to strategic suppliers is part of strategic purchasing.

Thirdly, the discussion so far should have made clear that a *strategic supplier* is a supplier that has to contribute to the SCA of an organization. Other authors prefer the term '*strategic partner*' or just '*partner*' instead of strategic supplier and speak about '*alliances*' to define these specific supplier relationships. However, our definition of strategic supplier completely differs from the common definition of strategic supplier that is based on Kraljic (1983), who states that a strategic supplier is a supplier of a strategic commodity (i.e. high supply risk, high impact on profit). The latter definition of strategic supplier has no (obvious) link with insights within the field of strategic management.

Fourthly, the first two activities of strategic purchasing can be illustrated by using two figures. In figure 3 an organization is modeled by the processes it currently executes and the goods and services it currently buys. These goods and services are positioned as commodities in the well-known Kraljic portfolio model (right in figure 3). The first two activities of strategic purchasing mainly focus on the processes an organization currently executes (left in figure 3).

Insert figure 3 here: Model of current organization 1

Fed by the first two activities of strategic purchasing, the processes that are currently executed by an organization can also be plotted in a matrix, based on two criteria (see figure 4):

1. the extent to which the business case that has been developed for a specific process, pleads for outsourcing this process or not.
2. the extent to which a specific process has to contribute to SCA.

Note that a business case that supports outsourcing decision-making should include all elements that are relevant in order to make this decision. That implies that such a business case also addresses the current and desired contribution of this process to SCA as one of the elements. Therefore, the two criteria mentioned above are not completely independent.

Insert figure 4 here: Model of current organization 2

Each quadrant in Figure 4 has its own characteristics. Quadrant I contains the core processes of an organization. These processes should be kept within the organization and should lead to SCA. Quadrant II contains the processes that have to be outsourced to strategic suppliers, who have to contribute to SCA. Quadrant III contains processes that have to be outsourced to independent suppliers. Quadrant IV contains processes that are kept in-house, although the organization recognizes that these processes do not contribute to SCA. These processes should be moved to another quadrant of the matrix, for example by developing a supplier a process can move to quadrant III. It should be noted that there is no apparent link between one of the quadrants I to IV and a quadrant in the Kraljic portfolio model: an outsourced process can appear in any of the quadrants of the Kraljic portfolio model.

Managerial implications and directions for further research

Based on the activities that strategic purchasing encompasses, organizations probably will have to (re-)design their purchasing function in order to get strategic purchasing organized. This could possibly mean that:

- Organizations establish procedures that support the organization in taking the right outsourcing decisions, amongst other by making use of supplier markets analyses. Currently, outsourcing decisions are often based on partial information, leading to flawed outsourcing decisions, generating fewer results than expected.
- Organizations identify their (true) strategic suppliers. Currently, many suppliers are called strategic without actually being strategic.
- Organizations establish a department that professionally manages the relationships with strategic suppliers.
- Organizations define and implement strategic purchasing performance measures. Current performance measures (like savings realized, on-contract buying percentage and purchasing efficiency) usually do not really address strategic purchasing.
- Organizations have to implement (new) ways of managing extended enterprises that create and maintain the SCA of an organization.

There are many directions for further research that could be explored. At this moment, further research is aiming at defining strategic purchasing performance measures and at operationalizing and testing the concepts related to the matrix shown in figure 4.

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Illustrations

Figure 1

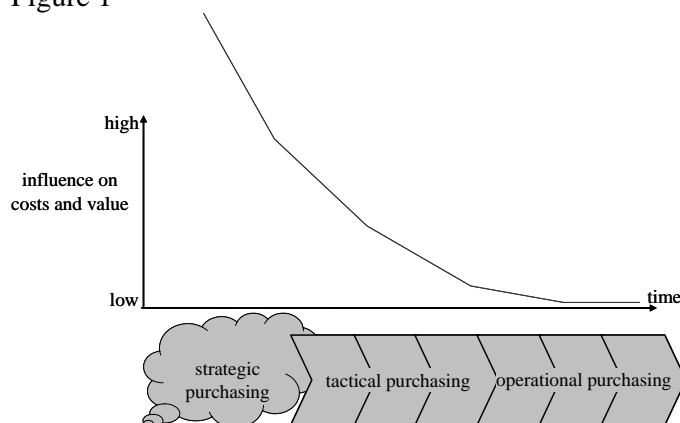


Figure 2

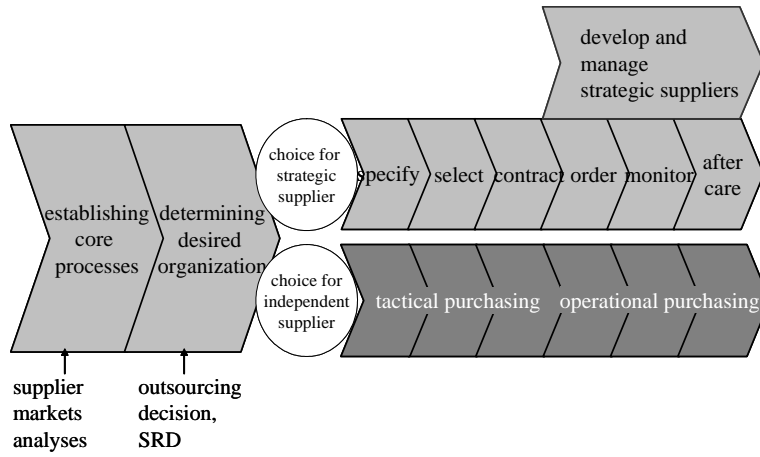


Figure 3

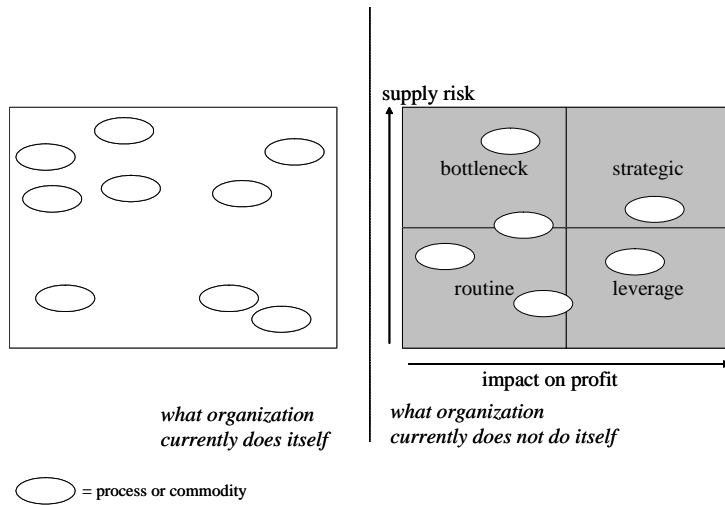


Figure 4

