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Hengda: Realizing The Potential of the Procurement Department

Qun Wu and Ziqian Zhao wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In September 2019, Gan Jiaquan was appointed manager of the procurement department of Jiangxi Hengda High-Tech Company Ltd. (Hengda), a Chinese company that produced anti-abrasion and anti-corrosion materials. As the new leader of the procurement department, Gan decided to immerse himself in the department’s daily business routine before rushing into any transformation decisions. Soon after his appointment, he met with all procurement department team members to gain a sense of the interactions that normally took place between his new department and the company’s other internal functions and external groups (i.e., suppliers). Gan also decided to carefully review previous procurement records and all written procedures.

Gan considered himself a very decisive person, but he was having trouble understanding some aspects of his new team’s operations. The procurement department seemed to have a complex relationship with other corporate and business functions (e.g., marketing, manufacturing, warehousing and inventory, and finance). It seemed to routinely receive and fill rush orders, which overwhelmed the department and negatively affected the team’s motivation to provide value to the company. However, Gan noticed that his team had lost any willingness to improve the situation and had become accustomed to the low-morale environment. Gan learned that his predecessors had tried to improve the situation in the department, but they had failed.

Even so, Gan decided that he could not accept failure as an option and became intent on addressing the systemic issues in his department. He believed that the reason his predecessors were unable to find a solution was because they did not look beyond the surface to find the root causes. Staring at the purchasing data on the screen and reflecting on his staff’s complaints, Gan wondered about the nature of the problems in his department. Where did the root causes lie? What would be the best strategy to address them?

Jiangxi Hengda High-Tech Company Ltd.

Hengda was established in 1993 as a chemical materials manufacturer. In the early years, it focused on research and development, manufacturing, and sales of anti-abrasion and anti-corrosion painting products. The company obtained multiple patents for its research. Hengda went public in 2011 and was listed on the small and medium enterprise board of the Shenzhen Stock Exchange. The company was widely regarded as China’s number one anti-abrasion and anti-corrosion stock. After becoming a public corporation, Hengda began to diversify into other fields. By mid-2019, the company was involved in waste incinerator (for energy saving and environmental protection) and acoustic noise reduction services. Over the many years of its development, Hengda had become an industry leader in China, maintaining rapid growth in both revenue and net profits for several years.[[1]](#footnote-1)

Unlike its early years, when the company had operated within a narrow business scope and simple business processes, Hengda currently operated using a functional department model, with several business departments operating under the supervision of the general manager’s office. These departments included human resources, procurement, manufacturing, warehousing and inventory, finance, and marketing (see Exhibit 1). Each department had its own mission and performance goals. The streamlined organizational structure allowed the company to increase its overall operational efficiency, which led to consistently favourable net profits. However, after Hengda became public and expanded its business lines, the company’s internal management structure became more complex, reflecting a wider business range and corporate ecosystem.

Increasingly, the procurement department had to deal with a larger number of suppliers and greater volume of materials. The manufacturing department had to become more innovative and was designing different production processes for new types of products. The warehousing department was required to manage more categories of inventory, while the finance department had to deal with complex payment requirements for raw materials. Even the marketing department, which interacted with different customer groups, was required to meet new volatility in demand. Therefore, business processes and information exchange among the company’s business departments became more entangled and complicated. Despite their individual silos structure, the various departments had to interact more frequently and their previous work processes were no longer effective in supporting the company’s growth. Internal collaboration was becoming a major challenge.

Gan and the Procurement Department

Before assuming his new role as manager of the procurement department, Gan had worked for 20 years at a Hengda subsidiary that conducted research and development, as well as sales, of metal materials and chemicals. Having gained essential experience in procurement and management, he was rewarded for his achievements by Hengda’s chairman of the board, Zhu Xinghe, who helped Gan attain a position on the company’s middle management team.

After investigating the status of the procurement department, Gan realized that the problems he identified in his department could be a company-wide issue. He might, therefore, face numerous hurdles in his attempts to resolve his own department’s problem. Nevertheless, he was optimistic that he could overcome any hurdles, and that career advancement opportunities could be his reward. If he could leverage his rapport with top executives and use his job experience to successfully resolve these problems, his contribution to the overall company would be considerable. As a result, he would likely gain more trust from his superiors and follow a path toward further career development. He felt pleased with this prospect.

Under Hengda’s structure, the procurement department operated in parallel with the marketing, manufacturing, warehousing, and finance departments. In addition to Gan, as manager, there were seven procurement officers in his department. The officers managed the purchasing of materials by category and based on production project requirements. The project cycle for the waste incinerator service was normally short—usually completed within one week—whereas the anti-abrasion and anti-corrosion business generally included just-in-time on-the-spot installation. Therefore, the company had to be very responsive to customer requirements. The job of a procurement officer included making purchase plans that included category, batching, and timing of each supply activity on the basis of internal orders, market supply, and inventory level. Thorough knowledge of market pricing of raw materials was necessary to perform cost analysis, cost control, and supplier selection and management, as well as to sign contracts and coordinate just-in-time delivery. Key performance indicators for the procurement department included completion of purchasing plans, completion of cost reduction targets, and punctuality of procurement (see Exhibit 2).

Gan knew that the company’s management had been neglecting the value of the procurement department. The company held patents for most of its products and these products sold well because there were not many substitutes on the market. In addition, suppliers usually offered favourable payment deferral terms to Hengda. Therefore, the executives had not been focusing on enhancing procurement efficiency to reduce costs. Gan decided that if he could make senior management see the value of his department, and if he could lead his staff to increase working efficiency, there was a potential to considerably reduce costs for the entire company. However, he sensed that the company was indifferent to the abilities of his department and of his team members. The general impression was that procurement officers simply placed orders and met production needs. Their responsibilities were considered easy and routine. Other departments assumed that procurement team members were not motivated to work effectively.

Gan reviewed the qualifications of his staff. He consulted their resumes and work reports for previous years. He found that only three procurement officers held a bachelor’s degree. The level of competence and professional ability among his staff varied widely. For example, they were instructed to simply follow directions, without requirements to perform effective data analysis tasks or make sound decisions based on data input. Based on his department’s complaints, Gan realized that it was understaffed and operated under considerable work and emotional pressure. He realized that the daily work of a procurement officer was not easy, as others assumed, but the lack of training and the nominal performance assessment may have been misinterpreted as proactivity. Based on employee feedback, Gan found that there had been many complaints from his department to previous managers about considerable pressure from both internal and external sources.

After careful thought, Gan believed he had found the root issue of the problems in the procurement department. All Hengda functional departments operated at an equal structural level, which meant that the procurement team interacted with internal clients (i.e., other functional departments) on a horizontal communication level. However, procurement officers had to abide by key performance indicators, such as procurement plan fulfillment rate, procurement quality, and just-in-time material supply for all the different internal customers, which often caused friction among the various business units.

That friction was reflected in the attitudes of Hengda workers when communicating with the procurement team, which led to a lack of information sharing among departments. Procurement officers had to go back and forth between departments and business units to retrieve necessary information and coordinate resources, which reduced the effectiveness of the department. The poor information sharing was further affected by an outdated internal communication system that was mostly paper-based. Tracing and retrieving essential data was an excessively time-consuming task.

The procurement department purchased a large amount of materials from external suppliers, and the selection and management processes for those suppliers involved considerable efforts. All supplier qualifications were evaluated using paperwork, rather than on-site inspections. Abiding by the company’s strict financial control, the primary consideration for any procurement decision was price; therefore, product quality, punctual delivery, service responsiveness, and quality were largely ignored by a procurement department that was already fully extended. Supplier relationships were therefore based on short or single duration. There were no differentiated terms available to specific suppliers, nor any attempt to maintain a favourable supplier relationship.

The lack of internal information sharing and coordination meant that there was no comprehensive procurement plan. The procurement department was therefore unable to provide suppliers with a proposed shipping schedule in advance. Suppliers often complained about being unable to schedule their own production process based on Hengda orders, and some refused to maintain a long-term partnership or offer co-operative service.

Gan made a list of all the issues he had identified and glanced over the items, which included low work efficiency, lack of planning, poor information sharing, and inefficient supplier management. Gan added another term to the list—*invisible wall*—and sat gazing at that key term for some time.

Invisible Wall

Gan decided that the root cause of his department’s low efficiency was the invisible walls between departments in the company’s silos structure. Each department head was fully in charge of that particular department and had the power to make decisions and perform performance reviews for that department’s team members. Therefore, before he could begin to transform the procurement department, Gan would have to influence change across the entire company. The first step would be to understand the roles and work processes of Hengda’s different departments, but he would have to cross the invisible wall between departments to do so. With a clear goal in mind, he began learning how the marketing, production, warehousing, and finance departments operated. He would then try and determine how his staff’s feedback was manifested in the processes of these departments.

Marketing Department

In Hengda’s early years, the company simply catered to the anti-corrosion paint market. At that time, the work of the marketing department was specific and well organized. In recent years, however, the company had extended its operations into multiple markets and product categories, including noise reduction products and waste incinerator services. Therefore, the company’s customer base was expanding and its configuration becoming more complex.

The procurement department and the marketing department represented two ends of the company’s value chain. Gan knew that it was the procurement department that interfaced directly with manufacturing, not the marketing department. However, the marketing needs and information came from the marketing department and indirectly influenced production and purchasing plans.

In recent years, it had become harder to make precise market projections, because the company had expanded into different fields with a wider ranging product catalogue. The manufacturing department forwarded its purchasing requirements to the procurement department according to market fluctuations. With large orders, the marketing department promoted specific product lines and tried to accelerate production for those products. Therefore, the procurement department had to place urgent orders to suppliers based on the marketing plan. Under this circumstance, both Hengda and the suppliers had to bear a higher cost and the risk of not being able to fulfill the required orders. Gan wondered if his department could receive market information directly from the marketing team, rather than relying on the manufacturing department to relay the information. Was it possible to enhance the entire chain’s market responsiveness?

Manufacturing Department

Based on Gan’s observations, the conflict between the manufacturing and procurement departments was the most evident issue in the company’s internal process.

Hengda was a manufacturing company. The primary responsibility of the procurement department was to ensure a smooth production process. Therefore, the procurement department and the manufacturing department interacted most closely. These two functional departments shared the main goals of ensuring production and quality. However, there were several differences in priorities. For example, the procurement team’s objectives included cost cutting and supplier management, which meant that its goal was to retain a moderate inventory level. However, the manufacturing department aimed to produce high-quality products in a timely manner, which meant that its goal was to keep raw materials in full stock at all times.

The company’s silos structure created invisible walls that caused information sharing blocks, and Hengda had made no efforts to correct this issue by implementing a proper information system. Specific production plans were not provided to the procurement department. Instead, procurement officers executed purchasing orders based on paperwork provided by impatient manufacturing staff, who were indifferent to purchasing plans or cycles. Procurement team members were therefore often blamed for production delays.

Warehousing Department

The warehousing department operated using a multi-level inventory model. In addition to common warehousing functions, this department also collected data from company warehouses operating at different levels of the organization and coordinated logistics among them. The central warehouse held tier-1 inventory, whereas the two workshop warehouses managed by the manufacturing department served all tier-2 inventory, consisting of materials received from the central warehouse. In addition, the sales department occasionally set up temporary warehouses at customer project sites. This model was designed to save logistics costs and improve efficiency.

However, the invisible walls had created an inadequate information sharing environment between the procurement and warehousing departments. Procurement officers could only obtain information about tier-1 inventory from the central warehouse. This issue made it difficult for the procurement team to operate effectively when placing orders with suppliers because they simply had no information on how much inventory was available at the company’s workshop warehouses or at various temporary project warehouses. By considering only tier-1 inventory and being unaware of the company’s other warehouses, the procurement team could inadvertently create an over-supply or overstock situation. On the other hand, if the department did not purchase enough supplies, it would be blamed for causing a production delay.

Finance Department

Hengda’s finance department was focused on improving the company’s profitability and capital turnover rates. To improve the company’s cash flow situation, the finance department worked on delaying payment to suppliers and collecting payables as soon as possible. The department had also been closely monitoring purchasing costs, based mainly on prices and payment deferral terms. However, the procurement department was required to meet the specifications outlined by the manufacturing department, which meant strategically selecting and supporting preferred suppliers.

During the initial part of the procurement process, the finance team did not directly intervene in procurement decisions. However, the payment process for supplies soon became an important consideration for this department. For example, questions were raised about reasonable pricing, selection criteria for suppliers, potential corruption in the selection of suppliers, contracts and payments conforming to company policy, potential risk to the finance department, and whether suppliers were properly registered with the commercial administration. To fulfill urgent orders, the procurement staff sometimes had to make quick decisions, which were usually questioned by the finance department.

Gan decided to meet with the manager of the finance department to ask about its scrutiny of the procurement team. Gan was informed that because the finance department was not directly involved in front-office business, it had to act as a gatekeeper for the company’s financial activities, which required a thorough understanding of every detail of the company’s purchases. Gan was informed that payment terms, for example, could have a great impact on the company’s financial health.

Suppliers

In 2019, Hengda’s total procurement expense increased sharply, to ¥269 million[[2]](#footnote-2) from ¥187 million in 2018. This coincided with the company’s expansion into the waste incinerator and acoustic noise reduction business lines. The impact of the expansion on the procurement team was working with a large variety of new materials and numerous new suppliers. Gan decided to meet with several suppliers and ask for their feedback, but he received mainly negative comments about Hengda’s procurement department. Not surprisingly, suppliers complained mainly about two issues: returns and the lack of a long-term procurement plan.

Suppliers claimed that they could not make appropriate production plans to fill Hengda orders without a proper long-term procurement plan. Urgent supply requirements were very costly to suppliers, who had to use overtime work to fill the orders. Returned goods were also a major issue, especially for goods with short expiry periods. Suppliers stated that returns from Hengda that had a long expiry date could be resold, but goods returned with short expiry dates had to be heavily discounted, recycled, or destroyed. All of these measures caused the supplier to incur costs.

Making Transformation Plans

After completing a thorough investigation, Gan realized that the problems manifested in the procurement department were actually deeply rooted in the lack of collaboration among departments. The company’s diversification in recent years had exacerbated this problem and added strain to the company. These problems posed great challenges for Hengda’s future development. Gan was concerned about the company’s long-term future and was determined to make a difference. But he also knew that it took more than a procurement manager to affect such important organizational changes.

He contacted Hengda’s chairman Zhu to proudly present his findings, but was disappointed by the chairman’s lack of enthusiasm in Gan’s report. After regaining his composure, Gan proceeded to carefully explain the situation. He informed Zhu about how the procurement department’s issues were related to the company’s silos structure, and was glad to see that his analysis was gradually earning Zhu’s approval. The chairman agreed that the silos structure had been a long-term issue, but explained that there were three main reasons why the company chose to retain its current organizational format.

The first reason had to do with corporate culture. Hengda had pursued a lean management structure to gain a competitive advantage in different markets. Corporate leaders had allowed great autonomy to sales departments to secure orders, and sales teams tended to satisfy every requirement from demanding clients. Therefore, other functional departments had to be highly responsive to the sales department, who represented the customer.

The second reason had to do with performance reviews of department managers, which emphasized departmental goals rather than the company’s overall operation. With individual departments pursuing their own bottom line rather than being aligned across departments, the company could promote a more competitive culture among departments, which benefited the company’s overall bottom line.

The third reason was in response to Gan’s recommendation to improve information sharing and save costs by revising the company’s organizational structure, moving positions, and investing in reengineered and improved information systems. Zhu stated that strengthening inter-departmental collaboration would require changing traditional and cultural practices. This would be very time-consuming and costly and did not necessarily guarantee business growth and increased revenue in a fiercely competitive market environment.

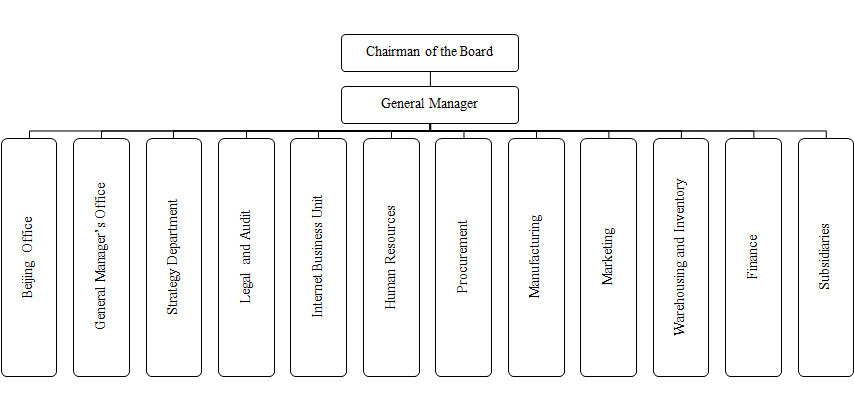
The chairman then stated that there was another issue related to acting on Gan’s report: Even if he agreed to support Gan’s initiative, who would be the right person to lead the transformation? Also, how would this person’s achievement be evaluated?

Gan was silently considering the chairman’s response. He agreed with Zhu that the situation was a systematic challenge. From the chairman’s viewpoint, there were other important considerations beyond individual employee problems, including maintaining a competitive edge, growing the company’s stock price, and ensuring appropriate timing and priority for investments. But Gan was still convinced that internal collaboration, cost-cutting, and enhanced work efficiency were indispensable steps for the company’s long-term future.

Zhu and Gan did agree on this point. Therefore, they decided that this direction of transformation for Hengda needed further contemplation and planning before it could be put into action. Gan returned to his office perplexed by the questions the chairman had raised and wondering what recommendations he would make in his next meeting with Zhu about the company’s future.

Qun Wu is an Associate Professor at Jiangxi University of Finance and Economics (JUFE).

Exhibit 1: Organizational Chart of Jiangxi Hengda High-Tech Company Ltd.



Source: Company files.

Exhibit 2: Key Performance Indicators for the Procurement Department

|  |  |  |
| --- | --- | --- |
| **Key Performance Indicator** | **Weight** | **Grade (Out of 100 points)** |
| Completion of the procurement plan | 15% |  |
| Completion of cost reduction targets | 25% |  |
| Punctuality of procurement | 25% |  |
| First pass yield | 25% |  |
| Administrative cost control | 5% |  |
| Supplier management | 5% |  |

Source: Company files.

1. Hengda’s revenue for the first six months of 2019 was ¥208,100,800 (approximately US$30,166,100), for 63.46 per cent growth over the previous year. The company’s net profit for the same period was ¥58,210,400 (approximately US$8,438,100), for 365.85 per cent growth over the previous year. [↑](#footnote-ref-1)
2. ¥ = Chinese yuan renminbi; US$1 = ¥7.16 on September 1, 2019; all currency amounts are in ¥ unless otherwise specified. [↑](#footnote-ref-2)