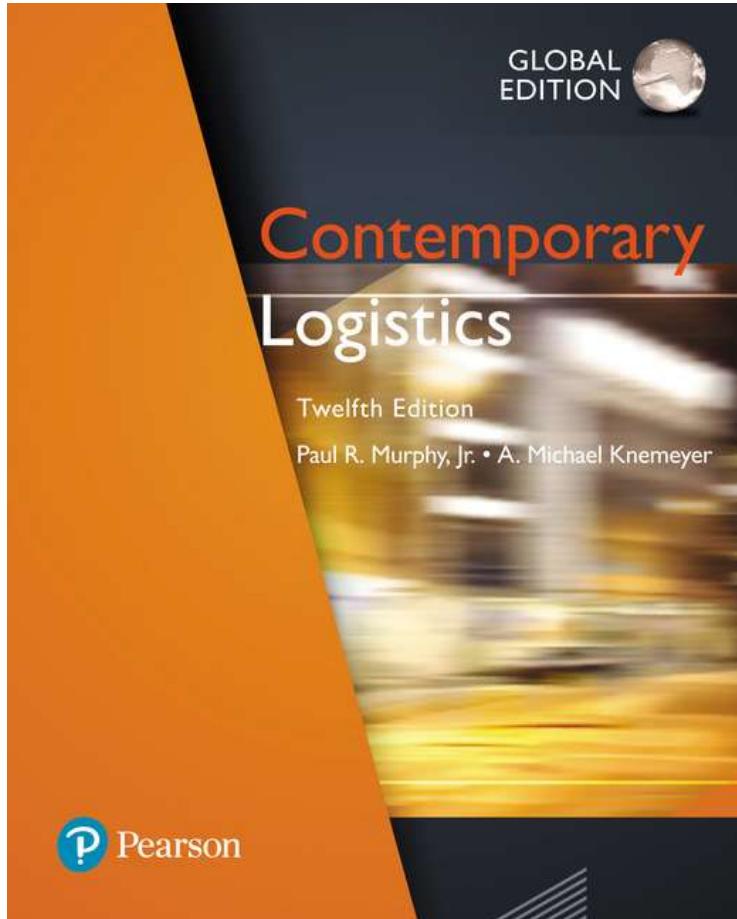


# Contemporary Logistics

Twelfth Edition, Global Edition



## Chapter 6

## Procurement

. This chapter is not theory — this is where money, power, and risk live in the supply chain.

# Learning Objectives (1 of 2)

- 6.1** To compare procurement, purchasing, and supply management
- 6.2** To review procurement objectives
- 6.3** To review supplier selection and evaluation approaches
- 6.4** To review Kraljic's Portfolio Matrix

# Learning Objectives (2 of 2)

- 6.5** To establish issues associated with global procurement
- 6.6** To identify social and environmental aspects of sustainable procurement
- 6.7** To describe the concept of supply chain finance and how it can be used in procurement relationships

# Procurement (1 of 7)

- When we say *procurement*, we are talking about **everything the company buys from outside** to operate and produce.
- Refers to the raw materials, component parts, and supplies bought from outside organizations to support a company's operations

• Raw materials

• Steel, oil, wheat, chemicals

• Component parts

• Chips, engines, batteries

• Supplies

• Packaging, office supplies, MRO items

**Discussion:** If procurement controls 70% of cost, **why do most CEOs come from marketing or finance, not procurement?**"

- Procurement costs often range between 60 and 80 percent of an organization's revenues

# Procurement (2 of 7)

- Currently has a more **strategic orientation** in many organizations
- Procurement manager may have responsibility for:
  - Reducing cycle times
  - Playing an integral role in product development
  - Generating additional revenues through collaboration with the marketing department<sup>1</sup>

Procurement is no longer about buying cheap — it is about **competing better**.

Discuss: Which of these three roles above is the *hardest* for procurement to achieve in real companies, why?

<sup>1</sup>John Hyatt, "The Rise and Rise of Procurement," *CFO* 28, no. 4 (2012): 57–59.

# Procurement (3 of 7)

- Is procurement the same as purchasing — or something bigger?
- “Procurement” and “purchasing” are sometimes viewed as synonymous terms.

Purchasing is a *subset* of procurement.

- **Purchasing:** Transaction-focused, Short-term, Operational.
- **Procurement:** Strategic + operational, Medium to long term, Cross-functional
- Supply management is viewed as a relational exchange approach involving a limited number of suppliers

Purchasing → Procurement → Supply Management  
(Transaction) (Strategy) (Relationships)

# Procurement (4 of 7)

Digital tools don't just make procurement faster — they change **behavior, transparency, and negotiation dynamics**

- Electronic commerce continues to bring many changes to the procurement discipline including
  - Electronic procurement
    - Procurement cards (p-cards)
      - Push control after purchase (monitoring) Instead of before purchase (approvals)
  - Reverse auctions:
  - Reverse auction = **buyers bid, suppliers compete.**
  - Instead of :Suppliers quote prices → buyer chooses

- Electronic procurement:
  - ✓ Buying through **digital platforms**
  - ✓ Automated workflows
  - ✓ System-based approvals

# Procurement (5 of 7)

- Procurement cards (p-cards)
  - Similar to Visa and MasterCard, but used for an organization's buying needs
  - Number of authorized employees is limited
  - Detailed statement is provided each month
  - Can implement control processes that:
    - Measure usage
    - Identify procurement trends
    - Limit spending during a procurement cycle
    - Block unauthorized expenditures

# Procurement (6 of 7)

- Benefits of procurement cards (p-cards)
  - Reduction in the number of invoices
  - Firm will make one payment each month regardless of the number of p-card holders
  - Allows employees to make purchases in minutes versus days
  - Generally allow suppliers to be paid in a more timely fashion

# Procurement (7 of 7)

- Challenges of procurement cards (expansion overseas)
  - Currency differences
  - Availability of technology
  - Difference in card acceptance
  - Cultural issues with the program

# Procurement Objectives

- Supporting organizational goals and objectives
- Managing the purchasing process effectively and efficiently
  - Effectiveness = buying the **right thing**  
Efficiency = buying it with **minimum waste**
- Managing the supply base:
  - More suppliers ≠ less risk
- Developing strong relationships with other functional groups
- Supporting operational requirements

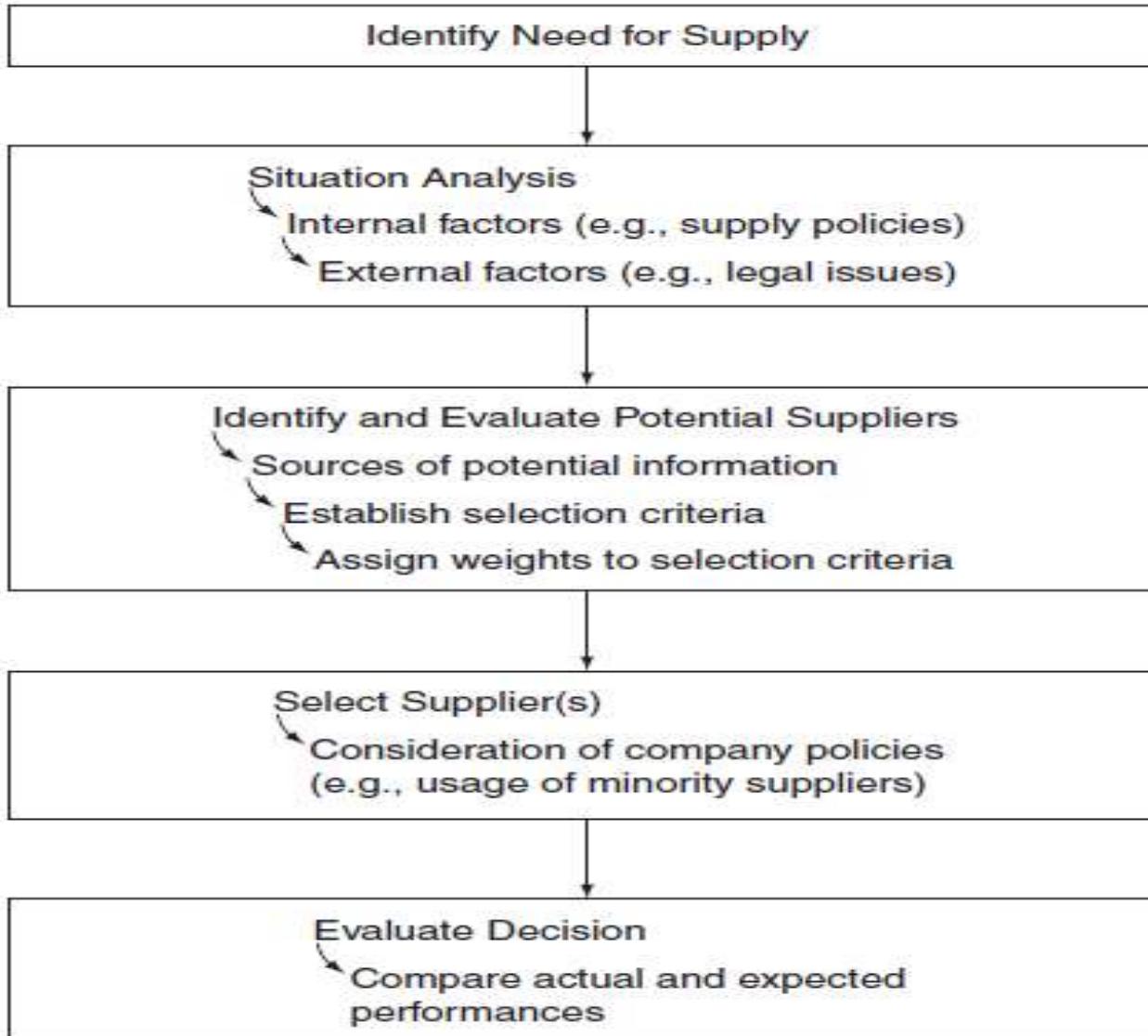
# Supplier Selection and Evaluation (1 of 3)

- One of procurement's most important responsibilities
- Involves stating an organization's needs and determining how well various potential suppliers can fulfill these needs

Procurement is not choosing a price — it is choosing a *partner* for risk and performance

- **Discussion:** Which is more dangerous: choosing a cheap supplier who fails, or an expensive supplier who performs reliably?

# Figure 6.1: Supplier Selection Framework



# Supplier Selection and Evaluation (2 of 3)

- Steps to supplier selection and evaluation
  1. Identify need for supply
  2. Perform situation analysis
  3. Identify and evaluate possible suppliers
  4. Select suppliers
    - Single-source approach
    - Multiple-source approach
  5. Evaluate decision
    - Process-based approach
    - Performance-based approach

Discuss: Which step do you think companies skip most often — and what are the consequences?

# Supplier Selection and Evaluation (3 of 3)

- Evaluate decision
  - Process-based approach
    - Is an assessment of the supplier's service and/or production process (supplier audit)
  - Performance-based approach
    - Is focused on the supplier's actual performance on a variety of criteria including cost and quality
    - Many companies use supplier scorecards to report performance information

**Discuss:** Would you trust a supplier with perfect processes but poor performance — or great performance but weak processes?

# Procurement Portfolio Approach (1 of 4)

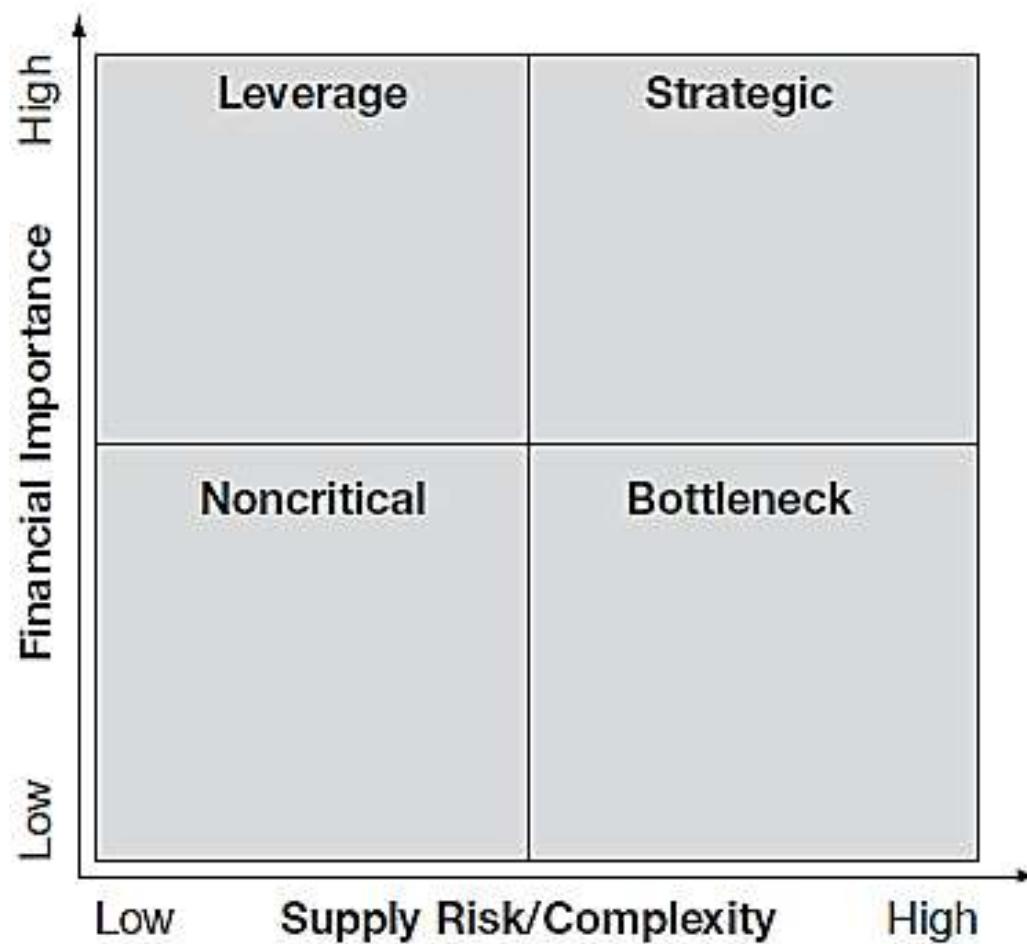
- Within the “situation analysis” step for supplier selection and evaluation, procurement managers must be continually aware of the supply and demand characteristics of the:
  - Raw materials
  - Component parts
  - Purchased supplies

# Procurement Portfolio Approach (2 of 4)

- Kraljic's Portfolio Matrix<sup>2</sup>
  - Used to classify corporate purchases in terms of their importance and supply complexity
  - Goal is to minimize supply vulnerability and getting the most out of the firm's purchasing power

<sup>2</sup>Peter Kraljic, "Purchasing Must Become Supply Management," *Harvard Business Review* 61, no. 5 (1983): 109–117.

## Figure 6.2: Kralijic Portfolio Matrix



Source: Peter Kraljic, "Purchasing Must Become Supply Management." *Harvard Business Review* 61, no. 5 (1983): 109–117.

# Procurement Portfolio Approach (3 of 4)

- Supplier development (reverse marketing)
  - Refers to aggressive procurement involvement not typically part of supplier selection
  - Can include:
    - Purchaser initiating contact with supplier
    - Purchaser establishing prices, terms and conditions, and other behaviors

# Procurement Portfolio Approach (4 of 4)

- Supplier development (reverse marketing)
  - Motivation to adopt supplier development includes:
    - Numerous inefficiencies associated with suppliers initiating marketing efforts toward purchasers
    - Purchaser may be aware of important benefits which are unknown to the supplier
    - Compel suppliers to meet necessary requirements to achieve competitive advantage in the supply chain

# Break: How Artificial Intelligence Revolutionizes the Procurement Industry

- Automated Supplier Selection
- Demand Forecasting
- Spend Analytics
- Supplier Risk Assessment
- Contract Management
- Fraud Detection
- Dynamic Pricing Optimization
- Automated Purchase Order Processing
- AI-Driven Negotiation Support
- Inventory Optimization
- Supplier Relationship Management
- Sustainable Procurement

# Global Procurement (Sourcing) (1 of 3)

- Refers to buying components and inputs anywhere in the world
- Driven by:
  - Factor-input strategy (organization is seeking low-cost or high-quality sources of supply)
  - Market access strategy (organization is sourcing in markets where it plans to do significant business)

# Global Procurement (Sourcing) (2 of 3)

- Components of global sourcing development model:
  - Planning
  - Specification
  - Evaluation
  - Relationship management
  - Transportation and holding costs
  - Implementation
  - Monitoring and improving

# Global Procurement (Sourcing) (3 of 3)

- Challenges in establishing a successful global sourcing strategy include understanding hidden costs as supply bases are expanded
- Examples of hidden costs:
  - Increased costs of dealing with suppliers outside the domestic market
  - Duty and tariff changes that occur over supply agreement life
  - Increased inventory-related costs associated with global supply chains
  - Rising levels of logistics cost volatility (e.g., ocean freight rates)

# Sustainable Procurement (1 of 7)

- Refers to the integration of social and environmental considerations into all stages of the purchasing process
- Goal is to minimize the impact of procurement activities on human health and the environment

# Sustainable Procurement (2 of 7)

- Social responsibility
  - Socially responsible procurement consists of five dimensions:
    - Diversity
    - The environment
    - Human rights
    - Philanthropy
    - Safety

# Sustainable Procurement (3 of 7)

- Social responsibility
  - Ethical considerations
    - “Win-at-all-costs” philosophy can exacerbate unethical behavior

# Sustainable Procurement (4 of 7)

- Social responsibility
  - Areas of ethical concern in procurement:
    - Gift giving and receiving
    - Bribes and kickbacks
    - Misuse of information
    - Improper methods of knowledge acquisition
    - Lying or misrepresentation of the truth
    - Product quality (lack of)
    - Misuse of company assets
    - Conflicts of interest

# Sustainable Procurement (5 of 7)

- Investment recovery
  - Identifies opportunities to recover revenues or reduce costs associated with:
    - Scrap materials
    - Surplus materials
    - Obsolete materials
    - Waste materials
  - Often the responsibility of the procurement manager

# Sustainable Procurement (6 of 7)

- Investment recovery
  - Can provide an organization the opportunity to simultaneously do well and do good in the sense that investment recovery:
    - Increases a seller's revenues (reduces a seller's cost)
    - While addressing selected environmental considerations

# Sustainable Procurement (7 of 7)

- Investment recovery
  - Even the best-managed organizations generate:
    - Excess (surplus)
      - Stock materials that exceed reasonable requirements
    - Obsolete
      - Materials not likely to ever be used again
    - Scrap
      - Materials that are no longer serviceable, have been discarded, or are a by-product of the production process
    - Waste
      - Materials that have been spoiled, broken, or otherwise rendered unfit for further use or reclamation (have no economic value)

# Supply Chain Finance (1 of 2)

- Refers to a set of technology and financed-based processes that strives to optimize cash flow by:
  - Allowing businesses to extend their payment terms to their suppliers
  - While simultaneously allowing suppliers to get paid early

# Supply Chain Finance (2 of 2)

- Transactions between buyers and sellers are facilitated by financial technology firms (FinTech)
- FinTech companies use cloud-based software to optimize the connection between procurement and accounts payable

# Key Terms (1 of 2)

- Bribes
- Excess (surplus) materials
- FinTech
- Global procurement (sourcing)
- Investment recovery
- Kickbacks
- Kraljic's Portfolio Matrix
- Multiple sourcing
- Near-sourcing
- Obsolete materials
- Procurement
- Procurement cards (p-cards)
- Purchasing

# Key Terms (2 of 2)

- Scrap materials
- Single sourcing
- Strategic sourcing
- Sustainable procurement
- Supplier audit
- Supplier development  
(reverse marketing)
- Supplier scorecards
- Supply chain finance
- Supply chain management
- Total cost of ownership  
(TCO)
- Waste materials