Module 1
Purchasing and Supply Chain Management

Session 1 Lecture- Purchase of Services

UMUC Purchasing and Materials Management

ASCM 626

Learning Objectives:	Readings:
After completing this lecture module, you should be able to: • Understand the differences between government and industry contracting • Discuss purchase of services in the public and private sectors • Determine how supply organization interacts within the firm • Understand organizational structures for supply management	• Session 1 Lecture - Introduction to Purchasing and Supply Chain • Session 1 Lecture – Purchase of Services • The Week 1 Reading List is a separate file that is posted in the Session 1 Content along with the Week 1 Lecture files. **Review:** • Week 1 Discussion Topics

Purchase of Services in the Public Sector and Private Sector

The salient difference between the government and industry is that government contracting is clearly bound by more rules than the private sector purchaser. The government must guard the public interest and the peculiar needs of the government. The private sector is under no such obligation, it is more focused on profits and losses. Congress has passed many laws regulating government purchasing. These laws often have social, political, and/or economic purposes. Based upon the laws, needs of the government and special rules grew special procedures that guide government procurement officers in administering their duties. Acquisition reform has been on the front burner of many federal government officials in the defense and civilian agencies. Steps have been taken to allow the government to conduct business more like the private sector. The federal government is slowly moving in the direction of private industry with regard to acquisition.

The expenditure for services by commercial firms, not-for profit organizations, and the government increase each year. In some cases the impact of the services on the success of the organizations operations is far greater than the impact of the dollar spent. Services range from architectural engineering, promotion, advertising, software development, maintenance, repair, and cafeteria and janitorial operations. Services that are not at the core of the organization’s competencies, such as management of information systems, payroll, travel services, delivery services and maintenance, repair, and operating (MRO) supplies are being outsourced to the private sector. Often suppliers have the expertise and economies of scale that allow them to provide services usually at the same or higher quality levels than the buyer and at a lower total cost. At another level, the economies that have traditionally been characterized by a high level of government participation in service delivery in the provision of health, transport, utilities, and municipal services, has seen large-scale outsourcing to the private sector.

The procurement of services is a challenging responsibility for the supply manager because the complex interdependency between the statement of work (SOW), method of compensation, source selection, contract administration, and customer satisfaction. The purchase of services will often lead to relationships with contractors that focus on trust rather than on the transaction. The SOW is the document that details a strategy for contractor and buyer to accomplish the objectives of the project. The planning phase of the SOW preparation is aimed at a thorough investigation of the why and what the project should accomplish.

The most critical prerequisite to the successful procurement of services is the development of the SOW. The supplier manager must provide the assistance needed in developing the SOW because most of their service customers lack training and experience in developing service requirements and specifications. Supply managers should invite two or three carefully prequalified potential contractors to aid in the development of the SOW. Early contractor involvement will aid the customer in understanding their needs and give the contractor insight into the level of effort required to fulfill the contract.

The SOW identifies what the contractor is to accomplish. The SOW should be clear, accurate, and complete and effectively spell out the delivery parameters. The SOW should clearly identify the customer's objectives and subordinate objectives. This tells the buyer and seller where and how to place their emphasis. Those responsible for developing the SOW must address whether timeliness, creativity, or artistic excellence are the primary objectives and how customer satisfaction is measured. One objective of the SOW is to gain understanding between the buyer and contractor concerning the specific nature of the technical effort to be performed. The satisfactory performance under the contract is a direct function of the quality, clarity, and completeness of the SOW. The SOW also affects the administration of the contract because it defines the scope or rather what the contractor is to do and what the buyer is to receive and how satisfaction is measured. The manner in which the scope is defined governs the amount of contract administration required by the supply professional during the life of the contract. A well written SOW enhances the contractor's performance of customer objectives.

Four major formats for the SOW (sometimes the four formats may be written as a hybrid or combination SOW) include:

> **<u>Performance SOW details everything wanted by the buyer.</u>** It is broken down into tasks describing the required outcome performance of the task(s).
>
> **<u>Functional SOW defines what the buyer is trying to do,</u>** leaving the contractor free to come up with the most efficient means of doing it.
>
> **<u>Design SOW is the most detailed type of SOW.</u>** It is used mainly in the construction and manufacturing of goods or equipment projects. This SOW requires plans, blueprints, CAD designs or specifications.
>
> **<u>Level of Effort SOW is a specialized type of performance SOW</u>** typically used in research and development, or studies contracts.

There are four keys to successful service contract administration:

1) A sound SOW;

2) Selection of the right source;

3) A fair and reasonable price; and

4) Aggressive management of the contract.

The administration of service contracts is a challenge for the buyer firm and the supply professional responsible for it. Supply professionals must monitor and realistically control the contractor's performance while nurturing relationships with the contractor(s). The supply professional can proactively manage the relationship with the contractor when they have access to accurate and timely data, including the contractor's performance plan and actual progress.

The FAR provides for 61 different tasks to be performed in administering public contracts. The Department of Defense (DOD) formed the Defense Contract Management Command (DCMC) to administer contracts let by all defense activities. The purpose was to provide specialized assistance through field office; avoid or eliminate overlapping and duplication of government efforts; and provide consistent treatment of contractors. Many government contracts provide for the inspection and acceptance of service at the source. Many government service contracts sometimes provide for the contractor to use government owned materials, tools, equipment and sometimes factories.

Source: Burt, D., Dobler, D., & Starling, S. (2003). World Class Supply Management; The Key to Supply Chain Management, Seventh Edition. In D. Burt, D. Dobler, & S. Starling, World Class Supply Management; The Key to Supply Chain Management, Seventh Edition. New York: McGraw Hill

Supply Organization

No organization is self-sufficient. Every organization depends on materials and services provided by other organizations. This dependence makes purchasing and supply chain a key business process. Senior management is responsible for managing the supply chain to create balance between the competitive environment, corporate strategy and organizational structure. This balance is necessary to meet the competitive challenges faced by the organization. The appropriate supply structure should be aligned with the organizational structure to deliver maximum benefits and compliment the organization's corporate strategy. How the organization aligned the supply function within the corporate structure will determine how supply interacts with other areas of the firm.

Objectives of Supply Management

Quintessentially, supply should obtain the right materials to meet all requirements, in the right quantities, for delivery at the right time, at the right place, from the right supplier, with the right service, and at the right price. These "rights" are often conflicting but must still be achieved simultaneously. The decision maker must balance these conflicting objectives and make tradeoffs to achieve the optimum mix in the short and long term. This often requires both a tactical and strategic perspective.

The overall goal of supply includes the following:

1. Improve the organization's competitive position – identify and exploit opportunities.
2. Provide an uninterrupted flow of materials, supplies, and services required to operate the organization – Avoid stock outs and late deliveries that increase cost.
3. Keep inventory investment and loss at a minimum.
4. Maintain and improve quality – rework is costly.
5. Find or develop best-in-class suppliers
6. Standardize items bought and processes where possible.
7. Purchase required items and services at lowest total cost of ownership.
8. Achieve harmonious, productive internal relationships.
9. Accomplish supply objectives at the lowest possible operating costs. The overall objective of supply is to contribute to the attainment of short and long term organizational strategies, goals, and objectives.

Organizational Structures for Supply Management

Small and Medium Sized Organizations

Assigning the supply function to properly trained supply professionals has been proven to contribute to the efficiency and effectiveness of the organizational goals and strategies. This is preferable to assigning the supply function to those who perform the duties as a secondary responsibility. There is no right or wrong way to incorporate the supply function into the organizations overall structure. The best fit is determined by the type of business and the type of business environment the organization operates in.

Small and medium sized organizations often assign supply responsibilities to a number of individuals with no supply expertise. As the size of the organization increases the idea of assigning the supply functions to individuals with more specialized expertise becomes more plausible.

Specialization within the Supply Function

Large organizations where supply functions are specialized often consist of the following: sourcing and commodity management, materials management, administration, and supply research. Within these functional areas supply professionals often have clearly defined responsibilities and expertise.

Large Organizations

The overall corporate structure sets the framework for the supply structure and is of major importance in most large organizations. The three common supply structure models include:

1. **Centralized supply functions** – Authority and responsibility for supply functions are assigned to a central unit (doesn't refer to geography).
2. **Hybrid supply functions** – authority and responsibility for supply decisions are shared between a central supply office and other business units, divisions or operating units.
3. **Decentralization** – authority and responsibility for supply related functions are dispersed throughout the organization.

Structure for Direct and Indirect Spend

Direct Spend (locus of control is highly centralized) - Any goods that go into the end product (requiring expertise).

Indirect Spend (often decentralized) – Goods and services that are needed to run the organization (purchasing authority and responsibility resides with the end user). Control and better management of Indirect Spend provides opportunities to realize cost savings, reductions and cost avoidance.

Managing Organizational Change in Supply

Most organizational structure change is the result of changes that occur in the overall corporate organizational structure. Supply management executives must learn to maximize the benefits of the organizational structure while minimizing the disadvantages. Since changes affect the lives of people within the organization, Supply Executives must work to minimize apprehension and fear during the implementation process.

When organizations move from a decentralized process to a centralized process the primary concerns are 1) sources of supply talent (existing talent may lack expertise); and

2) information technology (the use of new technology often creates fear and panic). The primary concern when an organization moves from a centralized structure to a decentralized structure is how the organization will effectively dismantle the current supply unit. The key to a successful transition in both situations is to preserve some of the organization's core supply capabilities and talent, while transitioning to the new organizational structure.

Organizing the Supply Group

Work assignment and execution within the supply function is key to its ability to successfully contribute to the organization's strategic plans and goals. In some large organizations the Chef Purchasing Officer (CPO) is the most senior or top level executive responsible for the management of the organization's strategic business unit's (SBU) purchasing decisions and sourcing functions.

Supply Activities and Responsibilities

Supply management involves a series of activities that must be managed effectively for the organization to provide best value to the final customer. According to CAPS Research the changing roles and responsibility of supply include managing the following:

1. **What is acquired**– items acquired vary by organization and items are added or deleted depending on the circumstances of the buying organization. Significant opportunities are present for organizations that can successful leverage the skills of the supply group and a structured sourcing process in the acquisition of nontraditional materials and services.
2. **Supply Chain activities**– Modern supply management organizations have responsibilities beyond the traditional buying activities associated with the function. Responsibilities are added and deleted and often vary by industry.
3. **Type of involvement** – Supply involvement ranges from "no involvement" to "meaningful involvement". The type of involvement in the daily activities of the organization also varies by industry and organization.
4. **Involvement in corporate activities**– strategic corporate initiatives involving supply management functions include mergers and acquisitions, new facility planning, new product development, outsourcing, revenue enhancement, technology planning, corporate e-commerce initiative, and corporate cost reduction initiative.

<u>Influence of the Industry Sector and Supply Activities</u>

The industry sector in which the organization operates influences supply responsibilities. The role of supply organizations in the manufacturing industry is uniquely different than one operating in an industry involving discrete goods. Private sector supply purchases may be for end user, internal use, operations, or external customers. Public, not for profit organizations often focus on internal end users. In some organizations, capital purchases may represent a large percentage of the total spend.

Supply Teams

The isolated functions of the past have been replaced by a greater dependence on cross-functional teams in the modern supply organization. Teams often bring together people from different functional areas to work on a common task. The idea is to bring together a broader range of skills and expertise to achieve the task. Cross functional teams are supposed to promote cooperation and better communication to achieve the end goal.

Leading and Managing Teams

Successful teams have the following in common:

1. Organizational support
2. Common purpose, measurable goals, individual and team feedback
3. Organized for customer satisfaction not individual functional success
4. All functional areas are involved in up-front planning, leadership, and flexibility
5. Qualified, skilled individuals who are available when necessary
6. A common agreed-upon work approach
7. Dedication to performance and implementation with decisions delegated to the appropriate level
8. Integration of all relevant functional areas and various teams throughout the project life cycle.

Besides Cross functional teams, other supply teams include:

1. **Teams with supplier participation** (assignment specific) – good when supplier capabilities and supplier responsiveness are needed.
2. **Teams with customer participation**– Customer driven approach. Ideal when there is a greater opportunity to deliver better value in the shortest cycle time.
3. **Co-location of Supply with Internal Customers**– Locating buyers with internal customers to foster greater awareness and better understanding of organizational goals, strategies, and challenges.
4. **Co-location of Suppliers in the Buying Organization**– Organizations look to suppliers for expertise and assistance. The supplier is located in the buying organization to improve buyer-seller communication and processes, absorb work typically performed by the firm’s employees and reduce administrative work and sales costs.
5. **Supplier Councils** – organizations consisting of several senior executives from a preferred supply base and from buying firms management, used to manage supplier relationships.
6. **Supply Councils**– organizations comprised of senior supply staff used to facilitate coordination among the business units, divisions, or plants. They share information and coordinate activities focused on a specific problem involving several supply groups.
7. **Consortia**– Purchasing consortia are comprised of collaborative purchasing entities (public and private) to obtain a wider range of services and goods at a lower cost.

Conclusion

There is no perfect organizational structure for supply. Its organizational structure will mirror the overall corporate structure. The challenge for supply executive is to maximize the benefits of their organizational structure, whether it is centralized, decentralized, or hybrid. Major research into organizational issues over the last decade has provided useful insights into innovative attempts to integrate the supply function and suppliers more effectively into organizational goals and strategies. No matter where the supply function is situated on the organizational chart, each individual member of the supply organization has the opportunity to improve relations with internal customers and suppliers in an effort to make a greater contribution to the organizational objectives.

> *Source:* ***Leenders, Michiel R.; Johnson, P. Frasier; Flynn, Anna E.; Fearon, Harold E., 13th edition, Purchasing and Supply Management, 2006, McGraw-Hill Irwin***

Values in the Work Place

The world economy expands. Firms seek customers across national borders. Cultural, legal, political and basic practices vary significantly around the world. What may be legal or acceptable in one country may not be legal or acceptable in another country. The way a business deals with these variances between cultures and what is legal or illegal is important to its ability to reach its target customers. Progressive organizations address the differences by creating and communicating to their employees across the world a set of principles and values that will govern how they operate regardless of the location. The principles are founded on the culture from which the company emerged. A situation in which something is legal and expected in one culture but illegal or inappropriate in another culture is an issue that purchasers and supply managers need to exam for their company and for their suppliers. The emerging reality is that companies are not only being held responsible for the things they do but also for the actions of their suppliers. In the eyes of their customers they may appear to be one company. Large global corporations also draw the attention of the government, here and abroad, special interest groups and the media. Purchasers are expected to penetrate their suppliers and hold them accountable to meeting the same standards as their internal operations. The use of a supplier half way around the world is no excuse for violating the law or socially acceptable standards. Public opinion of a company and its supply base is a powerful business driver that forces companies to be socially responsible.

Given the wide range of potential social issues, businesses must create a set of principles to develop and manage ethics in the workplace for suppliers, whether domestic or global. Government purchasers are not exempt from this social responsibility. In Texas, for example, a special responsibility is imposed on all purchasers entrusted with the disposition of the state funds. All Texas purchasing personnel are expected to perform with the highest integrity. State employees are entrusted with the safety and welfare of the citizenry. The nature of purchasing function in Texas makes it critical that all purchasing personnel remain independent, free of obligation or suspicion, and completely fair and impartial. Maintaining the integrity and credibility of a government purchasing program requires a clear set of guidelines, rules and responsibilities to govern the behavior of purchasing employees. Credibility and public confidence are vital throughout the purchasing and contracting system. Any erosion of honesty, integrity or openness tends to be more injurious to purchasing than to most other public programs. The shadow of doubt can be as harmful as the conduct itself. With this in mind, the state of Texas has implemented policies and procedures which govern the behavior of its purchasing personnel.

Diversity Programs

Many organizations and government entities have developed and implemented socio-economic programs. These include diversity programs, environmental protection programs and programs which promote values in the work place. A diversity supplier is considered to be a supplier who is African American, Asian/Indian, Asian Pacific, Hispanic, Mixed Minority, Native American, and Women. Diversity applies to any individuals and businesses that have challenges in becoming successfully established and gaining economic representation proportional with their demographic representation. Forces which motivate businesses to establish diversity programs include corporate social responsibility (a diversity program is the ethical thing to do); broadening the supply base to include diversity suppliers who mirror the buying firms customer base; and government compliance of federal, state and local regulations which may require their suppliers to spend a stated percent of their income from

government contracts with diversity suppliers.

Governments around the world are using diversity supplier programs as a mechanism to increase the participation of underrepresented members of the economies. The state of Texas has a Historically Underutilized Business (HUB) program similar to that of the Federal Government. A Texas HUB is a business with its principle place of business in Texas. HUB owner(s) have proportionate interest and actively participate in the business' management and are identified as economically disadvantaged according to 1 Texas Administrative Code (TAC) §111.12. The State of Texas HUB program is administered by Texas Building and Procurement Commission (TBPC) in accordance with Texas Gov't Code, Chapter 2161. The goal of the HUB Program is to provide equal opportunity for HUBs to obtain state business. The HUB mission is to encourage and effectively promote the utilization of HUBs by all state agencies, including institutions of higher education.

Some private sector organizations have developed and implemented diversity programs whose objectives are to ensure that diversity suppliers receive a fair share of the buying firm's expenditures. Commercial motivation for diversity programs, aside from those mentioned above, include: (1) fear of economic boycotts from diversity suppliers who feel they are being treated unfairly and may organize boycotts against targeted purchasers in order to gain leverage against the targeted corporation; (2) pass down provisions that require general contractors to include minorities and women among their subcontractors; and (3) increased competition because diversity suppliers provide products and services that are competitive with those of non-diversity suppliers.

Next Steps:

Complete the readings assigned for the module. Participate in class discussions.

As weeks of the course are completed, consider how you can explore each module to compare and contrast the understanding you have from your observations. What ideas seem to be most relevant? How might you adjust, fine-tune, or change your view of purchasing and materials management to become more effective in your career or organization?

Curious? Want to Know More?

Consider the UMUC online Library and use these search words:

- Differences between government and industry contracting
- Services in public and private sectors

- How supply organization interacts within the firm
- Organizational structures for supply management

http://www.umuc.edu/library/index.cfm is the Library Link.

More Web links with research and ideas:

- https://www.capsresearch.org/about-caps-research/ - CAPS Research is a team of hardworking people who are passionate about delivering high quality supply management research.
- http://www.sos.state.tx.us/tac/ - Texas Administrative Code (TAC)
- https://texreg.sos.state.tx.us/public/readtac$ext.TacPage?sl=R&app=9&p_dir=&p_rloc=&p_tloc=&p_ploc=&pg=1&p_tac=&ti=13&pt=7&ch=111&rl=12 - Texas Administrative Code Chapter 111 Rule 111.12.
- http://www.statutes.legis.state.tx.us/Docs/GV/htm/GV.2161.htm - Chapter 2161. Historically Underutilized Businesses.
- https://www.boundless.com/users/235420/textbooks/business-fundamentals/operations-management-7/special-topic-supply-chain-management-35/ - Supply chain management
- http://2012books.lardbucket.org/books/global-strategy/s11-global-supply-chain-management.html - Supply chain management
- http://ezproxy.umuc.edu/login?url=http://search.ebscohost.com/login.aspx?direct=true&db=ers&AN=89163828&site=eds-live&scope=site&profile=edsebook - Logistics management
- http://ezproxy.umuc.edu/login?url=http://go.galegroup.com.ezproxy.umuc.edu/ps/i.do?id=GALE%7CCX3405000091&v=2.1&u=umd_umuc&it=r&p=GVRL&sw=w&asid=dea1564ea8fdba4f7b8f8cbccc0b4484 - Supply logistics

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