

Centralised/Decentralised Procurement



It makes sense to think of purchasing authority on a continuum, with complete centralisation at one end and complete decentralisation at the other (Monczka et al., 2009)



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Introduction

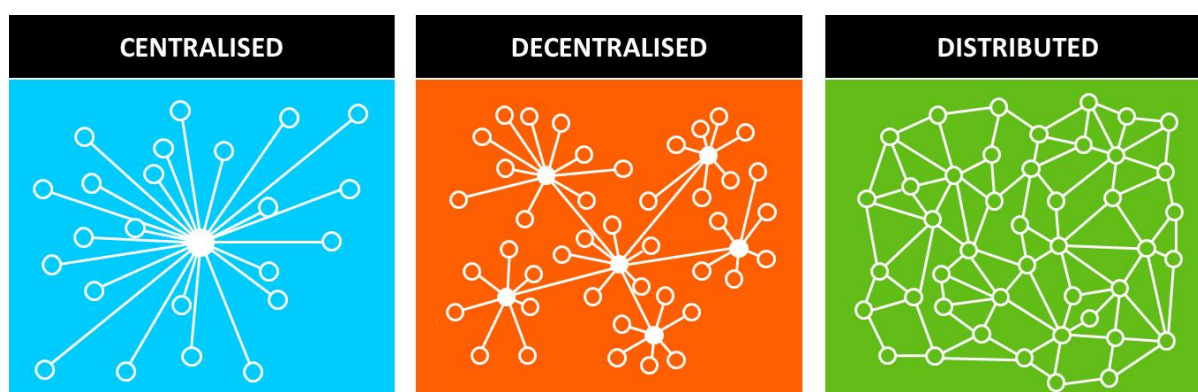
When the firm operates a centralised structure/model, a procurement officer at corporate headquarters has the authority for the vast majority of the firm's procurement spend. In contrast, when procurement authority for the majority of expenditures rests at the divisional unit, business unit, or plant/site level, then the organisation operates a decentralised structure/model. As such, (de)centralisation is less about structure and more about power and authority (Croom, 2000; Monczka et al., 2009; Potoski, 2008; Vagstad, 2000).

Monczka et al. (2009) suggest that organisations should think of purchasing authority on a continuum, with complete centralisation at one end and complete decentralisation at the other. Thus, certain decisions or tasks that will support an entire organisation may be centrally led (e.g the evaluation and selection of suppliers). The actual generation of individual purchase orders/contract releases can be located with individual business units. Different items may be subject to different authority levels: firms may centralise the authority for capital expenditure purchases over a specified dollar amount, while lower-dollar decisions can be made at local offices (Monczka et al., 2009). Few organisations are purely centralised or decentralised and most adopt a Hybrid approach.

Centralisation can benefit companies by providing the ability to leverage significant price reductions, and technical and environmental standardisation. Benefits of decentralisation lie in reduced opportunities for corruption and less scope for large-scale error and unnecessary overspending (CIPS Australia: Building the Case for Centralisation in Public Procurement). Regardless of whether the organisation's procurement function is centralised or decentralised, numerous challenges face the procurement team since the siloed nature of organisations can result in higher internal client engagement activity and costs, that is because of the need to re-educate on a project-by-project basis (CIPS Australia: Six Essays on Procurement). More often than not, individual business units or departments will have their own internal drivers and autonomy. Considering the reality of multiple organisational business units, aligning around a common procurement policy can take considerable time to achieve successfully (CIPS Australia: Six Essays on Procurement).

Definition

Centralised procurement implies that purchasing decisions are made either by company headquarters or some regional or divisional level. A decentralised procurement function means that an organisation's activities are spread over a number of plants or locations. More recently, it also refers to purchasing delegated to actual users (Lysons and Farrington, 2006).



Successful Application

Moving to a system of centralised or decentralised procurement requires considerable changes to policies, procedures, mindsets and actual purchasing behaviours. As a general rule, if the firm's strategy is to be responsive to individual customers in different markets, then a decentralised approach could be better. On the other hand, if the firm builds its competitive advantage through being more efficient than its competition, then a centralised approach to supply will probably be more advantageous (Arnold, 1999; Lysons and Farrington, 2006; Monczka et al., 2009).

Steps to Successful Application

- Establish a procurement committee to review the current procurement system: review the effectiveness of the system and how changes will affect technology, product or service purchasing, administration, people and business relationships.
- Discuss how levels of procurement authority will change under the new system, how these will be phased in, and the implications for spend.
- The committee should plan to revise current procurement policies and procedure documents to reflect future practices.
- Develop a document management strategy, including centralised location (if applicable), easily accessible to stakeholders and users, regular review of documents for necessary changes/updates, and a notification method for new or revised documents.
- For centralised procurement, establish ownership and processes to ensure companywide compliance.

Lysons and Farrington (2006); Monczka et al. (2009)

Hints and Tips

- Consider similarity of purchase: purchases that are quite similar across the firm can be combined for leverage under a more centralised approach. However, when purchases differ considerably across business units, decentralisation may be more preferable (Monczka et al., 2009).
- Consider total purchase expenditures: as the physical size of purchase expenditure increases, so too does the pressure to centralise. However, technology has levelled the effects of geographical dispersion meaning decentralisation is not out of the equation. Technology enables increased spend visibility irrespective of location (Monczka et al., 2009).
- Consider management philosophy: what are the current mentalities among management concerning procurement's level of centralisation? Exploring managerial attitudes will help to gauge the level of difficulty and potential obstacles in shifting further towards a centralised or decentralised structure (Monczka et al., 2009).

Potential Advantages

- Centralised procurement enables companies to achieve a favourable price due to accumulated volume (Arnold, 1999; Monczka et al., 2009).
- Centralisation often leads to the more efficient use of available procurement skills (Arnold, 1999; Mainville and Peterson, 2005).
- Centralised procurement can incur less administrative work and reduce purchasing organisation expenses (Arnold, 1999; Mainville and Peterson, 2005).

Potential Disadvantages

- Geographical, cultural, political, environmental, social language and currency factors are less effective or appropriate under centralisation vis-à-vis decentralisation (Lysons and Farrington, 2006).
- Bureaucracy tends to be greater in centralised procurement approaches (CIPS, 2006a).
- With centralised procurement there is often less scope for personal responsibility and less of a 'service mentality' (CIPS, 2006a).

Performance Monitoring

- When moving toward decentralisation, measure reductions in large-scale errors and unnecessary overspending (CIPS Australia: Building the Case for Centralisation in Public Procurement).
- Under decentralisation, measure and benchmark factors relating to local supplier relationships (CIPS Australia: Building the Case for Centralisation in Public Procurement).
- Measure the ability to leverage reductions in prices and expenditure under centralisation (CIPS Australia: Building the Case for Centralisation in Public Procurement.).
- Benchmark technical and environmental standardisation under centralised procurement arrangements (CIPS Australia: Building the Case for Centralisation in Public Procurement.).

Case Studies

- Honeywell relies on a decentralised procurement structure which helps to incorporate its OneSource spend analysis system. OneSource automatically gathers procurement data from 107 (eventually 152) Honeywell locations and data classification and cleansing is done as part of project rollout. Data cleansing has identified an overlap of up to 25% with other sites as new sites are added, and global supplier rationalisation has allowed Honeywell to achieve supply base reductions of between 40% and 50% (Monczka et al., 2009).
- Con-way Inc., named Fortune magazine's 'Most Admired Company' in transportation and logistics in 2007, is a US\$4.7bn freight transportation and logistics services company. Until 2006 the company adopted a hybrid procurement approach but its new CPO championed a centralised structure. The new structure improved efficiency, identified savings opportunities and created changes to help Con-way become more successful (Monczka et al., 2009).

- Hewlett-Packard has developed a largely atomised structure: over 60 business units act completely independently and are steered as profit centres. Each of these units has a procurement office. HP's central procurement department and International Procurement Offices (IPOs) act as profit centres and provide their business services to the unit procurement departments (Arnold, 1999). Further Reading/References

Further Reading/References

CIPS Source Downloads

- CIPS: Building the case for centralisation in public procurement

Web Resources

- The Economist on decentralisation
<http://www.economist.com/node/14298890>
- Key arguments for centralised and decentralised public procurement systems
<http://www.oecd.org/governance/procurement/toolbox/keyargumentsforcentralisedanddecentralisedpublicprocurementsystems.htm>
- Example of decentralised procurement in a university
http://www.procurement.virginia.edu/pagepuc_dlc
- Is centralisation the way forward
<http://www.supplymanagement.com/news/2009/centralised-strategy-finds-favour-with-procurement/?locale=en>
- Centralisation in a city council
<http://www.supplymanagement.com/news/2000/centralised-buying-sparks-major-revamp-for-council/?locale=en>

Books

- Purchasing and Supply Chain Management, Lysons and Farrington, ISBN 978-0273694380
- Purchasing and Supply Chain Management, Moncza, Handfield, Guinipero & Patterson, ISBN 978-0324381344
- Supply Chain Management, concepts, Techniques & Practices, Ling, ISBN 978-9812700728
- Global Purchasing & Supply Management, Pooler, Pooler & Farney, ISBN 978-1402078163
- Purchasing and Supply Chain Management, Van Weele, ISBN 978-1408018965

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- Potoski, M. (2008) State and Local Government Procurement and the Winter Commission. *Public Administration Review*, Vol. 68(S1), pp. S58-S69.
- Vagstad, S. (2000) Centralized vs. Decentralized Procurement: Does Dispersed Information call for Decentralized decision-making?. *International Journal of Industrial Organization*, Vol. 18(6), pp. 949-63.

Video

Centralisation and cost-reduction

https://www.youtube.com/watch?feature=player_embedded&v=rGSngNg3e94

CIPS Group Easton House, Easton on the Hill, Stamford, Lincolnshire, PE9 3NZ, United Kingdom
T +44 (0)1780 756777 F +44 (0)1780 751610 E info@cips.org

CIPS Africa Ground Floor, Building B, 48 Sovereign Drive, Route 21 Corporate Park, Irene X30, Centurion, Pretoria, South Africa
T +27 (0)12 345 6177 F +27 (0)12 345 3309 E infosaf@cips.org.za

CIPS Australasia Level 8, 520 Collins Street, Melbourne, Victoria 3000, Australia
T 1300 765 142/+61 (0)3 9629 6000 F 1300 765 143/+61 (0)3 9620 5488 E info@cipsa.com.au

CIPS Middle East & North Africa Office 1703, The Fairmont Hotel, Sheikh Zayed Road, PO Box 49042, Dubai, United Arab Emirates
T +971 (0)4 327 7348 F +971 (0)4 332 5541 E mena.enquiries@cips.org



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