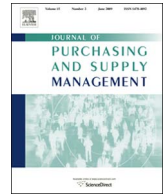




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Achieving efficiency and effectiveness in Purchasing and Supply Management: Organization design and outsourcing

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ABSTRACT

As a function with a strategic role, Purchasing and Supply Management (PSM) needs to continuously find ways to improve its efficiency and effectiveness. One potential way to specifically addressing efficiency targets is to outsource parts of the purchasing process. While outsourcing remains one of the most prevalent business practices in various areas, many businesses fail to realize the benefits anticipated from their outsourcing initiatives. Research reports that one major reason for these outsourcing challenges lies in the design of the focal organization. In this paper, we take an organization design view to outsourcing in the PSM context. Based on a multi-year case study from 2010 to 2013 at a global chemical and pharmaceutical company, we elaborate how the organizational design of the PSM function relates to outsourcing opportunities in order to increase efficiency and effectiveness by allocating internal resources to more value-adding activities. The case illustrates how an activity-based organizational design of PSM can support outsourcing of some parts of the purchasing process.

1. Introduction

Purchasing and Supply Management (PSM) has a key strategic role in many contemporary business organizations (Barney, 2012; Hayes et al., 2005; Van Weele and van Raaij, 2014). As firms increasingly rely on suppliers' inputs and contributions, the strategic importance of the PSM function as the interface managing these inputs has also increased (Van Weele and van Raaij, 2014). In the current global economy, PSM is under increased pressure to find additional value generation beyond efficiency seeking behavior and to search for effectiveness; for example by bringing in supplier product or process innovations, ensuring sustainability, and participating in product innovation activities (Barney, 2012; Caniato et al., 2012; Schiele, 2010, 2012; Turkulainen and Swink, 2016).

One of the fundamental managerial approaches to seek efficiency and effectiveness in different functional areas is outsourcing. Outsourcing has increased tremendously and has had transformational impact on how organizations manage their global operations and supply chains (Gray et al., 2009b). Despite its prominence, outsourcing continues to pose significant managerial challenges (Kroes and Ghosh, 2010; McIvor, 2009; Narasimhan et al., 2010) and many businesses fail to realize the benefits anticipated from their outsourcing initiatives (Gray et al., 2013; Handley, 2012; Handley and Benton, 2009; McIvor,

2000).

In this paper, we study outsourcing in the PSM context. Outsourcing in the PSM context refers to transferring tasks, such as order placement and source selection, outside the boundaries of the focal firm (Brewer et al., 2014; Maltz and Ellram, 1999). Understanding outsourcing in the PSM context is important as despite of its strategic nature (McIvor, 2009; Priem and Swink, 2012; Zimmermann and Foerstl, 2014), firms are increasingly outsourcing processes related to PSM and other supply chain management tasks (Kroes and Ghosh, 2010); outsourcing of PSM is expected to grow by 50% in the near future (Deloitte, 2014). Furthermore, PSM has a boundary-spanning role, connecting the firm to its supply base, implying that it is crucial to understand the outsourcing and relationships to service providers in the PSM context (Hartmann et al., 2012). Considering these aspects, having detailed understanding of outsourcing of PSM is critical.

While outsourcing has been addressed widely in the academic literature, research has focused on areas such as manufacturing or IT outsourcing (e.g., Gray et al., 2009a; Kaipia and Turkulainen, 2017; McIvor, 2000), and not outsourcing in the PSM context. Moreover, research on PSM outsourcing is considered "sparse, and also largely atheoretical" (Brewer et al., 2014: 187). In this paper, we aim to develop more detailed understanding of outsourcing in the PSM context. We address the following research question: *How does the design of the*

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purchasing and supply organization (PSO) support outsourcing parts of PSM? Understanding the organizational design aspects in the context of outsourcing is critical, as organizational design is one of the major reasons for outsourcing challenges (Ishizaka and Blakiston, 2012). We elaborate research on PSM organizational design and illustrate how a change of organizational design has supported outsourcing parts of PSM at a global chemical and pharmaceuticals company (Global Chemical Company GCC – a pseudonym).

This study contributes to research on PSM and outsourcing. First, the results give preliminary evidence on the relationship between an activity-based PSO design and outsourcing parts of PSM. Herein, an activity-based design refers to organizational design, which is based on bundling certain activities (rather than, say, business units) (Trent, 2004: 15). The organization design focus allows us to complement prior research on outsourcing of PSM (e.g., Amaral et al., 2006; Ellram and Billington, 2001; Nollet and Beaudieu, 2005). We also develop insight into one of the recent concerns of “outsourcing cascade” and the question of whether PSM follows manufacturing out the door (Brewer et al., 2013). And finally, the study complements prior research on organization design view to outsourcing in general (e.g., Handley and Benton, 2012; Narasimhan et al., 2010).

2. Conceptual background

2.1. Organizational design in the PSM context

Following Greenwood and Miller (2010), we use the term organizational design as a conventional designation for “organizational architecture”. In the PSM context, most research on organizational design has addressed the degree of centralization (locus of decision-making) at the firm level, describing PSOs as having a *centralized* or *decentralized* design (Arnold, 1999; Giunipero and Monczka, 1997; Glock and Hockrein, 2011; Johnson et al., 2014; Narasimhan and Carter, 1990; Schneider and Wallenburg, 2013). A *hybrid organizational design* also has been identified, combining aspects of both centralized and decentralized designs (Johnson and Leenders, 2001). In a hybrid design, for example, responsibility for negotiating some long-term contracts are maintained at the firm level, while subsidiaries place orders within the limits of these contracts (Trautmann et al., 2009a). Therefore, in contrast to centralized and decentralized designs, hybrid designs require both a global level and local level of analysis.

For developing understanding of the potential relationship between organizational design and outsourcing in the PSM function, the degree of centralization level fails to offer sufficient detail; there are potential variations in how companies might have organized themselves beyond the centralized-hybrid-decentralized framework. Classically, firms’ division of tasks and generic organization designs are assessed along functional, geography, and product-based dimensions (Galbraith, 2002). Taking a closer look at organizational designs for PSM reveals that companies can design their PSOs by purchasing categories, geographic area or product lines (Giunipero and Monczka, 1997; Karjalainen, 2011; Narasimhan and Carter, 1990; Trautmann et al., 2009b). Jia et al. (2014) highlight that firms can have four levels of purchasing: global commodity team (category), business unit (BU) purchasing, plant purchasing, and International Purchasing Offices (IPOs). Both plant level purchasing and IPOs could be considered as a geography-based design. Moreover, some practitioner research identifies activity as the fourth structural alternative beyond category, geographic area or product line (Procurement Strategy Council, 2009, 2013).¹ These four dimensions (categories, geographic area, product

lines, activity) reflect the main structural alternatives companies follow in designing the PSO at global and local levels (Bals and Turkulainen, 2015).

Recent research suggests that combining the centralization-hybrid-decentralization framework and the structural alternatives provides a new way to study PSOs and provides better understanding of the organizational designs (e.g., Jia et al., 2014, 2016); “centralization/decentralization of a purchase structure obviously depends on how the responsibilities are divided” (Jia et al., 2014: 290). Therefore, in this paper we draw together the centralization-hybrid-decentralization framework and the four structural alternatives of PSO design (category, business unit, geography, activity). This combined view serves as the organizational design framework that we empirically elaborate in an outsourcing setting to develop further understanding on the potential relationship between the design of the PSO and outsourcing.

2.2. Outsourcing

Outsourcing is defined as the decision to move some of a firm’s internal activities and decision-making responsibilities to outside providers (Gray et al., 2013; Jacobs and Chase, 2008). Economists, management scientists, and organizational theorists all recognize that the decision to make or buy product components and/or services, and the resulting impact on industrial organization is of paramount importance to firms (Anderson and Parker, 2002; Gray et al., 2009b; Handley and Benton, 2009). While existing research on outsourcing in general is both broad and abundant, it has especially focused on the decision of what to outsource (e.g., Bhalla and Terjesen, 2013; McIvor, 2000, 2009; Prahalad and Hamel, 1990). For the purposes of this study, we briefly review research on outsourcing taking the organizational view.

The organizational view to outsourcing suggests that outsourcing increases organizational flexibility (e.g., Schilling and Steensma, 2001). For example, external parties’ capacities can be steered more short-term in comparison to internal capacities (Bals et al., 2013) and to continuously restructure value chain and firm resources may become a key capability in itself and a source of competitive advantage (Fine et al., 2002; Pertusa-Ortega et al., 2010). The organizational view to outsourcing also provides understanding on the management of the outsourcing relationship with the contract manufacturer, suggesting that firms need to use various control, coordination, and supplier management practices to manage the outsourcing relationship (Handley and Benton, 2009, 2012, 2013; Kaipia and Turkulainen, 2017; Narasimhan et al., 2010).

Moreover, research on outsourcing with the organizational view emphasizes modularity, suggesting that a modular product structure and closely linked modular organization design have given rise to contract manufacturing in general and facilitate outsourcing (Benassi, 2009; Hoetker, 2006; Schilling and Steensma, 2001). In that context, modularity can be defined “as the extent to which the interdependencies between activities occur within, rather than across, Modules A and B. With no modularity [...], activities are not only interdependent on other activities within the same module, but also... on activities in the other module” (Asmussen et al., 2016: 916).

Although research on outsourcing in the PSM context is scarce (Brewer et al., 2014), the following conclusions can be made. Research in this area has shown how PSM can retain buying leverage for intermediate materials and components when it outsources manufacturing of the item using those materials and components (Ellram and Billington, 2001) and that well-devised contracting can improve outcomes in scenarios where procurement is outsourced alongside production (Yang et al., 2017). Research has also shown how purchasing groups might be formed with other firms (Nollet and Beaudieu, 2005) and how the procurement element of outsourced production can be managed so that companies can retain supply chain power and minimize risk (Amaral et al., 2006). Also, more recently, research provides specific examples of how to outsource sourcing of certain commodities

¹ A practice-oriented study suggests that companies structure their PSOs rather equally mainly by category (28%), activity (26%), and customer (24%), somewhat less by geography (17%) (Procurement Strategy Council, 2013). While the advent of such an activity-oriented organizational orientation in PSM was predicted by Trent in 2004 already, its realization was not reported in research until recently.

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