
How Purchasing Departments Should Operate Abroad



By David Midgley , INSEAD Emeritus Professor of Marketing

A context-aware approach to international purchasing may drive double-digit improvements in business performance.

Ask any manager at a large organisation why the purchasing department matters, and the first factor they'll mention will probably be costs. But cost control, though a core competency, is far from the only way purchasing affects firm performance. Every contract signed with a supplier represents a considerable amount of trust on the part of the buying firm. It's the purchasing department's job to ensure that trust is invested wisely, not squandered on the unworthy. Therefore, purchasing is obliged to be the organisation's eyes and ears within the supplier environment.

Of late, researchers have increasingly been studying how organisational structure may aid, or detract from, the purchasing function's decision making on the whole. Relatively little work, however, has been done on how structural issues may influence procurement outcomes across varying geographical and cultural contexts – an urgent question for any firm purchasing from international environments. For global business, there may not be one universal set of recommendations for handling purchasing.

Rather, success may depend on choosing the right organisational approach for the target environment, or vice versa. The demands placed on procurement may shift based on the strength of political and legal institutions in the source country, as well as the size of the cultural gap between that country and the purchasing firm's home nation.

In a recent paper for the *Journal of Purchasing and Supply Management*, my co-authors* and I found not only that the above effects are salient, but also that they are strong enough to have serious implications for purchasing performance and, by extension, overall firm performance.

Understanding international purchasing

We interviewed 195 German manufacturers about how they managed what they deemed to be their most important supplier relationship. Particularly, we wanted to know how they structured international purchasing, with an eye towards three major features:

- *Centralisation* – the degree to which purchasing decisions are made at corporate headquarters rather than local offices;
- *Standardisation* – the extent to which formal routines and processes (e.g. cost-benefit analyses, performance tracking, quality management) guide international sourcing decisions, regardless of context or circumstances;
- *Specialisation* – the involvement of professionals possessing skills for navigating the specific sourcing environment (e.g. knowledge of the culture and language concerned)

Using structural equation modelling, we sought to test the influence of the above features upon the firms' purchasing performance – in terms of cost, quality and time – as well as overall firm performance, as measured by profit, customer satisfaction and competitive advantage.

Results

Centralised procurement is an oft-cited best practice. Yet when sourcing from a culture vastly different from their own, or one with a less robust institutional environment (as in the case of many developing economies), should firms still lock up their purchasing decisions at HQ? It may seem that these complex situations would demand that managers get closer to the action.

However, we found that while centralisation was correlated with higher purchasing performance in general, decentralising in more demanding sourcing situations didn't make much difference. A review of the purchasing literature suggests there may be more effective ways of responding to uncertain supplier environments – specialisation being one of them.

Indeed, of the three structural characteristics we studied, specialisation had the most significant impact on both purchasing and firm performance. Not only was specialised procurement better across the board, but it especially helped the firms in our sample adapt to unfamiliar or ambiguous sourcing territory.

Finally, standardisation's impact upon performance was found to be highly contingent upon the purchasing location. It did drive higher performance for firms sourcing within their comfort zone, but did not aid learning in trickier purchasing situations. Unlike specialisation and centralisation, standardisation did not seem to have a positive impact on average.

Therefore, our paper contradicts some past studies that, all else being equal, find value in standardisation or see it as going hand-in-hand with specialisation to boost purchasing performance.

Purchasing and business strategy

Our findings strongly indicate that procurement managers should tailor their organisational structure to the purchasing environment. In doing so, they should account for the robustness of formal institutions as well as the **cultural distance** between the firm and the source country. A primary recommendation, given the strong influence of specialisation in our results, is for managers to invest in intercultural, technical and cost-analytical skills, particularly when sourcing in challenging contexts.

We also found that the effect of purchasing performance upon overall business performance is perhaps more striking than most managers imagine. Moderate on average, the effect was seen to strengthen with rising uncertainty in the purchasing environment. We speculate that **prior work** claiming that purchasing alone could bring about double-digit improvements in overall business performance was no exaggeration. In light of our results, we would argue for greater consideration of international purchasing as a core element of multinational business strategy.

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