

ROLE OF STRATEGIC SOURCING ON PUBLIC PROCUREMENT PERFORMANCE IN KENYA

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ABSTRACT: *The aim of strategic sourcing is to achieve large and sustainable cost reductions, long-term supply stability and minimization of supply risk. The purpose of this paper is to critically analyze the role of strategic sourcing on procurement performance in public institutions in Kenya. It has been noted that there is ineffective and non-reliable procurement procedures in public sector in Kenya, this can be attributed by the fact the there is no strategic considerations. This paper will focus on the following concepts supply management, role of IT, outsourcing and multiple sourcing strategies on procurement functions. It involved conducting a systematic review of literature papers in the field of strategic sourcing and procurement by means of content analysis to draw conclusion and recommendations. In conclusion, strategic sourcing increases an organization's buying power to maximize the leverage it has with suppliers for the purposes of reducing cost, enhancing quality and improving supplier diversity.*

ABSTRACT: Strategic Sourcing, Public Procurement, Performance, Sustainable, Cost Reduction

INTRODUCTION

Background to the Study

Organizations are operating in an environment characterized by countless economic and political disruptions to their sources of supplies and services. In order to survive in this turbulent marketplace, these organizations must continually monitor their competitive position as well as their internally controllable processes, especially the procurement process (Burt, Dobler & Starling 2003). The government ministries in Kenya are no exception. The government through various ministries annually procures billions of shillings worth of systems, supplies, and services in support of the government operations. As a result, modernization of procurement practices and processes presents government with a clear opportunity to leverage significantly improved value for money from its total spend on goods and services. According to McKinsey report (2009), government purchases of goods and services account for about 5%-8% of the GDP in OECD countries. In order to combat the mounting fiscal deficits, governments across the world have come under immense pressure to reduce their spending. One of the challenges of public procurement is inefficient cost cutting, lack of transparency even during negotiations, and hence competitive pricing will only have a limited impact on savings (Gabbard 2004). As a result, public sector buyers will be forced to revisit procurement practices and built an efficient and agile supply chain.

Strategic sourcing is probably the most significant aspect characterizing an organization's transformation to supply management. It is also this aspect of supply management which provides some of the most value-added benefits to the organization. Sourcing, one of the major steps in the procurement process, involves the identification and selection of the supplier whose costs, qualities, technologies, timeliness, dependability, and service best meet the

organization's needs (Reeds, Bowman & Knipper, 2005). Strategic sourcing involves taking a strategic approach to the selection of suppliers an approach that is more aligned with the organization's competitive strategy. Strategic sourcing reflects the integration of procurement or sourcing strategy with corporate strategy (Porter 1998). The integration of procurement and corporate strategy is reflective of the transformation of purchasing to supply management. Strategic sourcing is a well established and proven method for managing large-scale, medium to long term procurement activities. It has been adopted as standard practice by numerous public and private organisations in developed countries. It consists of two key capabilities - strategic contracting and category management (Arrowsmith & Trybus, 2003). In strategic contracting, the emphasis is on developing a detailed knowledge base of the market and the category being sourced, and using this knowledge to develop optimal sourcing solutions. Category management focuses on managing contracts to ensure that the negotiated contract benefits are realised, and driving continuous improvement in contract benefits year on year (Arrowsmith & Trybus, 2003). Supporting the implementation of the policy are other existing policies, extensive good practice guidelines and comprehensive tools and templates, including standard contracts and tender documentation (Callender & Mathews 2000).

Public procurement in Kenya has undergone tremendous changes reforms 1960 to date, with the enactment of key legislations, regulations and policies. However, a lot of concern has been raised by members of public and development partners on the lack of strategic focus in procurement plans, strategic policies and including lack of adherence the currently laid policies. Major scandals in Kenya, like in other countries, revolve around ineffective procurement procedures which could have been avoided by incorporating strategic policies in the public procurement cycle. It suffices to cite prominent Kenyan examples namely; the Triton scandal, Maize scandal, Anglo Leasing, Nairobi cemetery scandal among many others. It is argued that they were occasioned by lack or failure to adhere to procurement regulations by public officers. However, with strategic sourcing, such scandals could have been minimized. Despite the reform processes in public procurement and the employment of Public Procurement and Disposal Act (PPDA) 2005 as a strategic tool, there are predicaments in Kenyan public procurement practices, for example non-compliance with procurement related legislation and policies as well as tender irregularities. Pearce *et al* (2008) asserts that corruption has reached epidemic proportion in the world and is a major challenge to managers and policy makers.

Procurement officers face other challenges when implementing prequalification procurement such as cost implication, lack of technical experts to evaluate, time constrain and evaluation standard setting. Agreeably Mamiro (2010) in his findings underscores these facts and concludes that one of the major setbacks in public procurement is poor procurement planning and management of the procurement process which include needs that are not well identified and estimated, unrealistic budgets and inadequacy of skills of procurement staff responsible for procurement. Similarly, Kakwezi and Nyeko (2010) argue that procurement performance is not usually measured in most organizations as compared with the human resource and finance functions. They conclude in their findings that failure to establish performance of the procurement function can lead to irregular and biased decisions that have costly consequences to any public procuring entity. This study therefore, is aimed at investigating the effects of strategic sourcing on procurement performance in public institutions. This is justified due to the fact that none of the previous literature on public procurement in Kenya has critically analyzed the role of strategic sourcing in procurement function and performance.

Purpose of the study

The purpose of this paper is to investigate effects of strategic sourcing on procurement performance in public institutions in Kenya. This paper will be guided by the following research questions: What are the effects of supply management strategy on procurement performance in public institutions? What are the roles of; information technology, outsourcing and multiple sourcing strategies on procurement performance of public institutions in Kenya?

METHODOLOGY

This paper conducts a systematic review of literature papers in the field of strategic sourcing and procurement by means of content analysis. Kassarian (1977) stipulates that content analysis should follow a clear and purposeful process structure that enables researcher obtain informative and credible results to make research conclusion and recommendations.

Result and Discussions

Having elaborately reviewed literature from multiple sources, it is established that strategic sourcing is a supply management tool that delivers significant cost reductions and other benefits. More specifically, it's a periodic event that includes the identification and selection of initial commercial arrangements with a selected supplier that either creates or resets a relationship (Nakumara 2004). Most companies are already involved with some form of Strategic Sourcing initiative. Typically, when professionals define Strategic Sourcing they limit the scope and therefore the impact of a strategic sourcing initiative. However, strategic sourcing can go well beyond cutting costs. It can have a profound impact on a company's financials and can strongly influence the purchasing and procurement processes (Thai 2001). Public procurement is an important function of government for several reasons. First, the sheer magnitude of procurement outlays has a great impact on the economy and needs to be well managed. Indeed, in all countries in the world, estimates of the financial activities of government procurement managers are believed to be in the order of 10% – 30 % of GNP (Callender & Mathews, 2000). Efficiently handling this size of procurement outlays has been a policy and management concern as well as a challenge for public procurement practitioners.

The transformation of the purchasing and procurement function from a passive, administrative, and reactive process to a proactive, strategic, boundary-spanning function was predicted back in the early 1960's purchasing literature when Henderson stated that the procurement function would gain increased importance in corporate management (Henderson 1975). As we continue into this new millennium, the purchasing and procurement transformation continues to build up steam and reap benefits for leading-edge organizations. The procurement transformation reflects a new approach to purchasing and procurement that embraces the other supply chain management functions of materials management, logistics, and physical distribution, this new approach has been labeled - supply management by many organizations and industries (Bhote 1989). This supply management focus requires organizations to adopt a strategic orientation to their procurement function and to look more at the total supply chain management process and its effect on the organization's competitive strategy. More specifically, the supply management focus involves linking the organization's procurement strategy with its corporate competitive strategy. This requires supply managers to become active participants in developing their

organization's strategic business plan, which now includes the integration of supply, marketing, finance, and conversion strategies (Burt 2003).

Supply management has been described as a new management concept that integrates the company's purchasing, engineering, and quality assurance functions with the supplier, working together as one team early in the procurement process to further mutual goals (Thai 2001). Of course, the supply function has always existed in all organizations ensuring that all needs are met in terms of quality, quantity, delivery, cost, service, and continuity. The new concept described focuses on supply management's strategic contributions to organizational objectives, such as the opportunistic or profit-maximizing aspects. Strategic sourcing for instance is defined as the process of evaluating, selecting and aligning with suppliers or consortiums of suppliers to achieve operational improvements in support of an organization's strategic objectives (Nakumara 2004). It is used when the activities of sourcing are directly tied to a sourcing strategy. Strategic sourcing is probably the most significant aspect characterizing an organization's transformation to supply management. It is also this aspect of supply management which provides some of the most value-added benefits to the organization (Burt 2003). It involves taking a strategic approach to the selection of suppliers—an approach that is more aligned with the organization's competitive strategy. Strategic sourcing reflects the integration of procurement or sourcing strategy with corporate strategy. The integration of procurement and corporate strategy is reflective of the transformation of purchasing to supply management. One example of strategic sourcing is the commodity sourcing strategy, which focuses on developing a specific sourcing strategy for a category or group of supplies or services. This is just one application of strategic sourcing: the development and application of a carefully crafted strategy for the procurement of quality supplies and services at the lowest cost (Gabbard 2004). The success of commodity strategies is based on maximizing the cost-reduction advantages of leveraging combined buying power for volume discounts, using market experts to formulate a sourcing strategy, and finally, forming strong relationships with preferred suppliers (Reed *et al.* 2005).

It was clear that strategic sourcing has traditionally been associated with consolidation opportunities. Although increased business opportunities for suppliers and perceived competition will result in delivered savings, these are typically one-time savings opportunities. However, when an organization approaches suppliers talking about strategic opportunities, looking for ways to integrate that improves the performance of both organizations, and discussing/evaluating the savings opportunities from a total cost perspective, the process becomes less contentious. Now, both parties are talking about creating value, not shifting profit from one organization to another. Successful strategic sourcing professionals will develop an understanding of their position in the marketplace: how important purchasing is relative to the whole market demand; the position or importance of suppliers in the marketplace; the balance of demand and supply, cost drivers, i.e., raw materials, manufacturing processes; new entrants into the marketplace or consolidation trends; substitutes or alternatives; and finally, suppliers' or alternate suppliers' capabilities and overall strategies (Harland *et al* 2005). Having this understanding will help an organization be proactive to changes in the marketplace, understand ways to leverage suppliers' capabilities for lowest total cost solutions, and finally better prepare for negotiation opportunities.

Organizations in this range lack the scale to make significant headway by pooling their own spend across the business, but can outsource indirect categories to a vendor that can in turn bundle this spend with that of other companies to obtain favorable terms. Consumer products

and financial services companies have been leading the inquiries about procurement outsourcing based on a combination of their familiarity with outsourcing other functions and their sizable (but often undermanaged) indirect spend (Monczka *et al.*, 2005). Procurement outsourcing is also unique when compared to the many other types of business process outsourcing (BPO), as it does not come with the baked-in guarantees that vendors usually deliver in other functions. An early willingness to share spends data and an honest assessment of present-day capabilities is a must during the vendor selection process. Where a capability is found to be lacking, the question then is whether it can be improved through an internally focused effort or by outsourcing (Kotabe *et al* 2008).

With rapid wealth growth in emerging global economies, the basis of competitive advantage is switching from internal competencies to network capabilities (McEvily and Marcus, 2005). In the environment of networked global economy outsourcing is regarded as an important strategic tool that allows firms to concentrate one's own core competencies for building flexible inter-organizational capabilities (Lacity *et al.*, 2008). Outsourcing activities include transfer of non-core activities to suppliers for the purpose of securing specialized expertise and lower costs. Manufacturing firms moved their internal manufacturing and operations to lower cost countries. Reasons for such outsourcing practices include low-cost strategy, proximity to foreign markets and easy access to innovative capabilities. In this highly competitive global environment, in recent years, the scope of outsourcing has extended to include core business activities and innovative new projects. Traditional low-cost manufacturing or limited outsourcing arrangements are no longer adequate to ensure sustainable competitive advantage. Outsourcing is more than a tool for functional value extension but strategic priority practice. The diverse sets of outsourcing benefits include lower cost, more investment on core competencies, flexibility, reduction assets and complementary capabilities (Hansen *et al.*, 2008). In the course of pursuing outsourcing benefits firms also face serious challenges as well (Bahli and Rivard, 2003).

According to the latest Bain Survey, 77 percent of their research sample companies have outsourcing policy and yet more half of the companies do not achieve the expected benefits from outsourcing. Outsourcing risks involve disruptions of internal activities, loss of competitive base, opportunistic behaviors, rising transaction and coordination costs, limited learning and innovation and higher procurement costs in relation to the fluctuating currency exchange rates (Kotabe *et al.*, 2008). Firms carefully consider the benefits and risks and optimize the outsourcing effects to sustain their long-term competitive advantages (Busi and McIvor, 2008; Lacity *et al.*, 2008). Naturally, outsourcing is becoming increasingly strategic (Gottfredson *et al.*, 2005; Hoecht and Trott, 2006). In view of these growing opportunities and increasing challenges, this study intends to provide a useful insight in analyzing the outsourcing practices for better procurement functions in public sector.

Multi-sourcing is also an approach in strategic sourcing; the enterprise customer (or its shared-services captive acting as a procurement unit) pre-qualifies multiple service providers in the same field of service. Each receives a suite of projects under an ongoing contract for multiple years. But the pricing and scope of work are based on competitive bidding for individual projects (Chen and Gant 2008). The scope of work and the method of performance need to be comparable, if not identical, to ensure that competing bids will result in comparable service delivery. By avoiding sole sourcing, the "multi-sourcing" strategy provides an immediately available backup supplier in case the primary supplier of an in-scope service should fail to meet quality standards. Further, the enterprise customer retains the freedom to allocate projects or

services between the two service providers (Qu and Brocklehurst, 2003). By avoiding the big-bang of a monolithic scope, the enterprise customer can increase or decrease scope on a periodic basis and thereby use ongoing competition to inspire cost reductions, improved quality and attentiveness, and even some innovation in the design of the services, all for the customer's benefit.

The emergence of the new Information and Communication Technologies (ICTs) has also offered promising opportunities as regards the efficiency, transparency and opening-up of public procurement (European Commission 2000). Technology advances such as the Internet and on-line proposal/bid processes have created competitive environments that may not previously have existed, but have caused current suppliers to be more responsive to an organization's financial objectives. However, before conducting an on-line event, it is important to understand the market characteristics to mitigate risks and prevent undesirable results. Through an understanding of strategic objectives and the marketplace, sourcing professionals can evaluate and modify supplier relationships to achieve the desired results.

CONCLUSION

Sourcing by identifying and locating suppliers is relatively simple, but it becomes more complex as the amount of unique raw materials, ingredients, parts, components, connectors, apparatus, products, equipment, supplies, and services increase and the numbers of buyers involved in the decisions expand. In a global enterprise, it is possible for one purchasing decision to impact numerous business processes or departments including manufacturing, receiving, distribution, marketing, sales or customer support. The risks of buying the wrong items, services or from the wrong supplier can have major impacts and ripple throughout a business. Consequences can range from late delivery to total service failure liability and can even affect market competitiveness. In addition, if the selected suppliers cannot provide opportunities to reduce costs improve and upgrade product/service offerings or provide other market-facing advantages, then an organization can quickly find itself losing market share.

Ultimately, strategic outsourcing in procurement functions is the solution. Strategic sourcing begins the critical process and lays the foundation for creating value through the purchasing process. When looking at the macro or top-level view of the approach to strategic sourcing, it is difficult to assess what is different from the traditional sourcing approach. However, when looking at the definition of strategic sourcing and then evaluating what needs to be addressed from a critical success factor perspective and why, the differences should become apparent. The critical success factors previously discussed will vary slightly depending on an organization's current situation. They are not meant to be all inclusive nor imply that if addressed, success is guaranteed. However, they do represent a solid checklist for determining how likely an organization will be in achieving and adapting to the objectives of strategic sourcing.

RECOMMENDATIONS

From the finding emanating from the discussion above, the following are recommended steps that organizations has to adhere in order to fully incorporate strategic sourcing in procurement functions:

Sourcing stage - In this stage, individuals or groups analyze, assess, and select vendors and their goods and services based on certain specifications and requirements. This relationship is typically documented in a contract with terms and conditions regarding products, services, prices, and service levels.

Purchasing and Procurement Management – this is a stage which is established after Sourcing to execute upon the contract and to supply the enterprise with required goods and services at the negotiated price and agreed-upon times. These actions are typically represented in purchase orders (POs) or release orders/instructions on Master POs. POs are communicated via phone, fax, mail, EDI, etc. The Internet has proven to be a highly effective tool for sourcing and procurement. Strategic Sourcing has been e-enabled through web applications, marketplaces and portals that support auctions, reverse auctions, etc. Procurement has also been e-enabled through web applications, marketplaces, and portals that support requests for information (RFIs), requests for quotes (RFQs), purchase orders, logistics arrangements, payment, etc.

The final building block is Supplier Relationship Management (SRM). Managing and partnering with suppliers is important from sourcing through procurement. Integrating operations and establishing mutually beneficial programs are essential to a successful organization. By adhering to these recommendations, the organizations are able to strategically carry out procurement functions that will result in efficiency and cost saving.

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