

Purchasing Consortia in the Public Sector Models and Methods for Success

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The public sector reform movement has spawned increased interest in consolidation and outsourcing as a means to optimizing the public tax burden. The push for purchasing cost efficiencies can create complex dilemma for administrators, whether functional activities are managed centrally or distributed. For those managing the purchasing function, the situation has become a squeeze play. While there is increasing pressure to reduce commodity costs to meet budget cuts; budgets to achieve these expectations have themselves been drastically cut. With the demand for efficiency gains in annual spending intensifying, the more successful an organization is in achieving their targets, the more likely it is that targets will become increasingly stringent (in Carter and Greer in Pollitt 1995). This translates into a drive for greater cooperation across the public sector, a drive notably evident in the formation of purchasing groups among school systems, hospitals, municipal governments and universities.

A Case for Collaboration

More than 90% of purchasing managers surveyed pointed to lower prices as the principal objective inter-agency co-operation. Process efficiency and reduced workload are also highly important. Other objectives include improved quality and service; as well as opportunities to share new technologies, expertise and best practices.

Cooperative purchasing is the pursuit of efficiencies, namely purchase price efficiency and purchase process efficiency. While purchasing coops have existed for many years, increased pressure for new savings has heightened interest in purchasing consortia as a means to achieve savings on commonly purchased products. Seeking to leverage their collective size, organizations consolidate their common needs to achieve *best-for-all* supply agreements. In more recent years, the concept has included the acquisition of common services and facilitation of shared services. Evidence suggests, however, that administrators looking for new savings year-after-year are probably chasing an elusive goal. Most astute purchasers already reduce prices through various strategies, but when these efforts are combined with other organizations, the collective contracts usually generate additional savings in the first and possibly the second year. Many experienced purchasers suggest, however, that there is a limit to how much groups can continue to squeeze the market for lower prices alone.

Defining the Purchasing Consortium

Thomas Hendrick defines the purchasing consortium as "two or more independent organizations that join together, either formally or informally, or through an independent

third party, for the purpose of combining their individual requirements for purchased materials, services and capital goods to leverage more value-added pricing, service, and technology from their external suppliers than could be obtained if each firm purchased goods and services alone" (7). The common purpose here is evident - a mutual gain in cost/price performance and service enhancement across the membership. J. Sean Kenney adds a complimentary definition and looks to the forces driving the cooperation, "A coalition, at its most basic level, is an alliance of usually diverse and separate parties that come together to achieve a collective purpose (12).

John Ritchie, London Universities Purchasing Consortium, sees the consortium "in the context of a business plan with three key elements: extending the use of agreements based on whole-life costing; progressively reducing transaction and process costs, and the provision of more qualitative added-value service" (Tulip 30). The concept advances cooperative purchasing from a reaction to outside forces or top-down pressures, to a supply methodology congruent with an overall business strategy.

Many coalitions come together seeking to aggregate requirements for a common buy. It is likely that savings will be achieved, proving the value of the coalition. The logical next step is to consider where the value need is the greatest and to pursue the coalition approach in that area (Kenny 13). In the basic group buy for example, the characteristics of coalition members may matter little so long as they can standardize on the product or service as delivered by a supplier without much concern as to how it used internally. Value stems from reducing the unit cost. On the other hand, the more common the characteristics, the more likely that variable needs can be satisfied through a collective initiative.

When consortia are successful others will be anxious to join, but size is not necessarily the key to success. According to Sam Tulip, writing for Supply Management, the attributes conducive to successful co-operation would include "common values and interests, similar external challenges, geographical proximity and a desire for group success" (25). This raises additional questions about the relationship between the nature of the product/service being purchased and the nature of the buying organizations themselves. One can begin to envision a complex matrix of variables that a consortium might need to consider in determining which purchases to pursue collectively and which to leave to the individual institution.

The fit between members is relatively easy to achieve in the public sector, but it is the variance between structures that may shift the consortium in different directions. While many consortia are initially formed to aggregate and leverage volumes, as savings reach optimal levels other objectives may take precedence (Tulip 25). Fred Harvey, former director of UK's Eastern Shires Purchasing Organization, expects many consortia of the future will offer the benefits of expertise rather than scale (qtd. in Tulip 25). Once the best value price has been achieved through collective contracts, the sensible thrust in cooperative purchasing is to advance efficient purchasing technologies, reduce wasteful consumption and to improve the application of goods and services. The collective effort begins to focus on achieving value through best practices – buy smarter and use smarter.

The perception of control in the decision process seems to be as important to the success of the group as the nature of the organizations and their requirements. Scaling-up,

especially where government imposition leads to regional or national buying agencies usually requires staffing and management roles that may push member participants further from the decision making processes. As Tulip notes, "Imposing national agreements that may have been developed without full user participation risks an emphasis on price at the expense of product, service and market development" (30).

Models of Cooperation

Leenders and Fearon note two variations of purchasing cooperatives: (a) joint buying and (b) formal contractual arrangement where several groups agree to fund a separate coop agency (562). In the first, two or more purchasing entities pool their requirements of a particular requirement, but only one makes the quantity and price commitment with the supplier. The second variation requires a formal contractual arrangement among the participants to establish and fund a separate agency for the purpose of providing purchasing services to the members. Since most coalitions in the public sector are modeled on a not-for-profit basis, savings are generated with little cost to members and as a result, the vast majority of savings flow directly to members (Kenney 13).

Sam Tulip takes a broad view of the model, "There are many different ways of organizing a purchasing consortium, a voluntary combination between two or more organizations that is designed to aggregate and maximize their purchasing power in a market" (25). In the UK, Steve Gilbey, chairman of the Central Buying Consortium describes two basic models, the joint committee and the federation (Tulip 25). Both are owned by their members, but are separate legal entities. In terms of contract activity, "the joint committee has a single contract between the supplier and the consortium, which then sells to individual members. However, in a federation, each member contracts directly with the supplier, but on the basis of jointly negotiated prices, specifications and terms" (Tulip 25).

This research revealed five structural models of purchasing collaboration operating across Canada, the United States and the United Kingdom, (1) local networks, (2) voluntary cooperatives, (3) regional purchasing agencies, (4) member-owned service bureaus and (5) for-profit enterprises. These range from loosely structured relationships under the control of institutional purchasing managers to highly structured business models with complete autonomy.

Local Network

In the *Local Network*, one or more institutions join together to obtain better pricing, share information and in some cases, share resources. These relatively informal relationships are most common within a system-wide effort, but are often formed from a mix of public entities having a geographic proximity. Members will usually agree to a few working rules for the task at hand. Supply contracts may be based on aggregate demand or follow the piggy-back approach.

Volunteer Confederation

The *Voluntary Cooperative*, a confederation, is the most common model of collaboration noted in the study whereby purchasing managers carry out competitive sourcing based on needs defined by the participating institutions. Cooperatives range from relatively informal committees to highly structured groups. Organizations share data and the work is distributed amongst volunteer members who strive to secure best-for-all agreements for

standardized products or services. In most of the examples investigated one member acts as lead agent, often based on previous experience or expertise. The designated lead agent is responsible for research, tendering and contract management.

Regional Purchasing Agency

The *Regional Purchasing Agency* provides services to government bodies by a centralized authority. In these pseudo-cooperative consortia, the government retains a degree of control; institutions may or may not be compelled to use centrally negotiated agreements. While the fundamental objectives are the same, control and the opportunity for input is somewhat limited for member organizations.

Member-Owned Service Bureau

The fourth model of collaboration occurs when two or more institutions create a separate entity to provide services to the participating organizations. Policy is established by a board of representatives from the member organizations; operations are carried out by paid staff. The *Member-owned Service Bureau* pursues the benefits of outsourcing without giving up control of policy and direction. Success depends on a higher level of support from member organizations who play a active role in setting directions.

For-Profit Enterprise

The *For-Profit Enterprise* is in the business of selling its purchasing clout and expertise. The firm usually takes on of two approaches, (1) the enterprise purchases goods based on the aggregate demand of its clients and then resells the goods at cost plus a profit margin; or (2) the firm acts as an agent for the client by negotiating price and services based on the same aggregate demand and charges a commission for its services. In the second example, title passes directly from the supply source to the buying organization. Neither approach calls for speculative buying since most purchases are based on volume commitments pre-negotiated with clients. Unlike the *Volunteer Cooperative*, clients do not form a relationship with each other, nor do they necessarily discuss their common requirements. The relationship between buyer and agent may be the result of operations in common, such as health care groups, or based on market specialization, such as natural gas or electrical power.

Measuring Savings

The most oft cited objective of purchasing groups is to achieve economies of scale by leveraging collective volumes. But the measurement of those savings has been a challenge for most groups. Purchasers may recognize the benefits of peer support, information sharing and fostering professional development, but most governing authorities look to cooperative purchasing as a means to reduce costs in an environment of ever shrinking resources.

In *The Problem with Purchasing Savings* (1998), Mike Leenders underscores the difficulties in measuring and attributing savings (336). Each organization likely has its own savings target but these may not be in sync with the group targets. How will the cooperative determine the baseline and who will be accountable? Leenders explains these challenges as *confusion of purpose* and *measurement miseries* (336). "Aside from confusion of purpose, it is not easy to measure supply savings fairly. At least five major factors influence

the ability to measure savings well: (1) inflation; (2) volume changes; (3) technology changes; (4) market changes; and (5) accounting interest" (Leenders 1998 337).

Claims of savings range from 10% to 25% but only a few have tracking systems. Measures used are: (a) group price compared to price paid by individual institutions, (b) group price compared to list price, (c) group price compared to prices paid by other organizations, (d) group price compared to last price paid and (e) year-to-year group price variances compared to published indices.

Success Indicators and Barriers

All groups appear to derive some value for their collective efforts, but some factors seem to suggest why some do better; i.e. the cognate and proximate characteristics of the group. Findings suggest success is more likely when the members are more alike in terms of product/service application, governance and geographic location. Executive involvement and breakthrough initiatives occur when member organizations have an equity stake in the consortium.

Despite the obvious benefits, there can be disadvantages such as longer lead times and loss of control over the timing and choice of materials and services. The concern is often one of sacrificing authority to a centralized body which may impose suppliers, contracts and spending methods across the system. But consortia can't easily take advantage of short-term opportunities or respond to rapid changes when members must return to individual authorities for approval.

On the other hand, J. Sean Kenney notes, "Purchasers not united in a coalition approach will be increasingly disadvantaged. Small purchasers will become increasingly thwarted as providers shift more of the cost of discounts granted to coalitions and other large purchasers onto smaller purchasers who have less negotiating strength" (13).

The success of consortia is greatly dependent on team performance. John Myers identifies three sources of barriers to team performance: the organization, the leader, or the team members themselves (140). Among organizational barriers, Myers notes lack of vision clarity and insufficient resources in terms of time, money and personnel (140). Individual skill is as important to the group's success as other factors. When skills don't develop to serve goals beyond the individual's own organization, the consortium struggles to remain viable. Within most successful groups, however, one usually finds individuals who can assume a leadership role in mentoring and training opportunities (Finn 2000).

The role of the supplier in purchasing consortia is underutilized. Good buyer-supplier trust and respect will help move the bi-directional flow of information. Suppliers can provide market information, track order cycles and consumption rates, provide supply cost data and recommend affordable alternatives. In many industries, the supplier represents the best source of expertise and can often make suggestions on how to improve the purchase and use process to help users reduce waste.

A number of success indicators were found among groups that achieved higher rates of participation and long term satisfaction: (a) careful selection goods, services and suppliers, (b) supplier capacity, (c) member and executive commitment, (d) compatible purchasing

philosophies, (e) defined goals and performance measures, (f) process and contract management and (g) supplier involvement.

Summary

Purchasing in the public sector is shaped by legislation, public policy, political agendas and internally by institutional philosophies and citizen clients. These factors distinguish public from private-sector purchasing by the source of pressures, but doesn't suggest that one is easier than the other. Public purchasers do not frame their decisions by easily recognized business indicators, such as profit, but they are driven by a complicated financial system of budgets influenced by authorities outside of the institution. It is within this environment that public purchasers have employed consolidation and co-operation to achieve improvements in purchasing results.

The two dominant approaches to cooperative purchasing are joint contracts and piggy-back agreements. Structural models include local network, voluntary cooperative, regional purchasing agency, member-owned service bureau and for-profit enterprise. Purchasing managers cite a variety of objectives in joining a consortium, but emphasized purchase price savings and process efficiencies.

The Internet and the emergence of e-marketplaces will bring about a new era of collaboration between buyers and co-suppliers. Cost benefits and compressed cycle times are the payoff for demand aggregation on-line, whether driven by the supplier, the buyer or an intermediary. There is no perfect model of purchasing collaboration, but there is considerable evidence that most groups are on the right path. There is compelling evidence of the benefits of organizational investment and paid professional management.

Participants in this study foresee a future of intensified funding constraints, increased pressure to find new sources of value and greater adaptation of new technologies. Purchasing collaboration is more than the consolidation of existing purchasing activities; the next logical step is to determine where value improvement is most needed. Purchasing managers working together can challenge, consult, and compare with best practices. The key to making all this work is a willingness among consortia partners to forgo a degree of independence in return for the obtainable benefits and a necessary measure of trust and confidence in the collective capabilities of the group members.

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