Making Purchasing Work for Smaller Organizations

Michael E. Smith, Ph.D., C.Q.A.
University of Western Carolina
828/227-3697; mesmith@wcu.edu

Lee Buddress, Ph.D., C.P.M.
Portland State University
503/725-4769; leeb@sba.pdx.edu

90th Annual International Supply Management Conference, May, 2005.

Introduction. Small businesses are a critical part of the economy, but they receive relatively little attention either in terms of public policy or scholarship relative to large firms. This neglect fails to recognize the impact of small businesses on employment, as innovators, and as important contributors to the supply base of large businesses. The vast majority of research in supply management addresses best practices and emerging issues within large businesses. The nature of the resources available to large businesses to implement managerial systems suggests that the high degree of formality and resource intensive nature of many current supply management approaches may render adaptation to the resource-constrained small business environment difficult, if not impossible. This session focuses on identifying difficulties specific to small organizations and proposes several methods to address these issues.

Small Business Environment. The U.S. Small Business Administration (SBA) defines small businesses as those with fewer than 500 employees. According to the Small Business Administration (2004), in the U.S., 99.7% of all employer firms, employing half of the private-sector employees, and paying more than 44% of the private-sector payroll employ fewer than 500 people. These firms are a critical component of the national economy, and account for more than 50% of the non-farm gross domestic product.

Small businesses are a critical component of any solution to the current economic doldrums. In fact, it seems likely that without the contributions of small business, unemployment would have soared, potentially driving social unrest, not only during the recession, but well in advance of the recognition of economic tumult. At the close of the 20th Century, small businesses accounted for almost all of the net increases in employment in the U.S. economy (Small Business Administration, 1999), and during the recessionary period at the start of the 21st Century, job losses would have been substantially exacerbated had it not been for the growing number of small enterprises (Small Business Administration, 2004). From 1994 through 1998, about 11.1 million new jobs were created, and virtually all of those jobs were the generated by small employers with fewer than 500 employees (Small Business Administration, 1999). More than 78% of these new jobs were in firms with fewer than 20 employees.

Small businesses also represent a substantial fund in the commerce of innovation. Recent data indicate that nearly 40% of high technology workers are employed by small businesses, and those workers generate more than 13 times as many patents per employee as do the remaining 60% (Small Business Administration, 2004). Further, evidence suggests that the patents generated by small firms are more often cited in advancing innovation.

At a time when the trade deficit raises cries of alarm, small businesses also disproportionately address that concern. Data from 2001 indicate that 97% of the exporting firms in the U.S. are small businesses, and these small exporters produce nearly 30% of the identified U.S. export value (Small Business Administration, 2004).

Thus, small firms represent a powerful force in addressing economic development, advancing societal interests and obtaining innovation, all of which render such businesses important contributors as suppliers and a segment where support of effective business processes could pay handsome dividends. While large businesses may provide supplier development activities toward such businesses both as an aspect of corporate social responsibility and a matter of sound business practice, it is difficult to understand the relative lack of support from other parties for developing SCM practices tailored toward small businesses if we believe that SCM can benefit the performance of such enterprises.

The Challenge of SCM for Small Businesses. Does a small business need proficiency in SCM? According to Chapman, Ettkin and Helms (2000), the answer is a resounding yes. Indeed, for a small organization to operate effectively in creating value for its customers, it must be managed in a way that allows it to do what even large organizations have found difficult. We can all recall the stories of the IBM's and GM's of the world, and how creating a useable product with its attendant services, requires extensive internal networks. In fact, the need for these internal networks, at least in theory, contributed to the initial development of the large organizations (e.g., Micklethwait and Wooldridge, 2004).

The small organization finds itself pitted against this internal network. If the small organization is not initially competing against organizations with extensive internal networks, then the competition will come with the development of a market, for with the market will come potential competition.

In order to compete with the internal network, a small company has the immediate need to craft a network of suppliers and distributors that can be more effective than can those housed under one roof. One might say that the core competencies of the emerging organization are first to develop concepts that will add value for the ultimate customer, and then to obtain and coordinate the external web of organizations that will be necessary to deliver the substance of the initial concepts to the marketplace with truly exceptional differential value.

To deliver on this premise means that the organization must coordinate the necessary resources in its surrounding environment to present the business to outside observers as fundamentally seamless with its cooperating chain of suppliers and distributors (Knechtges and Watts, 2000). Such coordination is at the very heart of SCM, and small firms are implementing SCM, whether they recognize it or not (Chapman, Ettkin and Helms, 2000).

While small firms are already engaged in SCM, this is not sufficient to ensure that these efforts are well managed. According to Chapman, Ettkin and Helms (2000), small firms may, at least conceptually, have advantages over larger firms in implementing SCM. These advantages include a chance to incorporate SCM into organizational strategy as it is developed, and less bureaucratic resistance to changes associated with implementing SCM. Unfortunately, the extent to which such considerations result in success is not known.

Other authors have found that smaller firms do have an advantage in maintaining effective communications within the organization (Lee, Bennett and Oakes, 2000), and thus, may have an advantage aligning internal processes with SCM. However, internal changes that support interest in SCM represent only part of the implementation battle. A small organization must also gain the ascent of other organizations, and must then manage those relationships effectively. Recent research suggests that there is considerable variation in the extent to which small and medium sized organizations have actually been effective in fostering collaborative relationships, either with suppliers or with customers (Bresnen and Fowler, 1997). One of the challenges for small businesses is that their intended business partners may both have more sophistication and may have more power in the relationship due to factors such as doing a relatively small portion of their overall business with the small organization (Cox, 2001).

Hingley (2001) found that there was need for greater formality in the practice of relationship management among the smaller firms in supply chains. Greater formality was associated with success in face of imbalances in power and may support smaller businesses in avoiding becoming the base of the economic food chain (i.e., avoiding being consumed in the processes of serving others, see Knechteges and Watts, 2000). However, mere measurement and the implementation of information technology do not adequately inform the development of systems for effective management of relationships. This leaves the question of other practices, and reasonable sources of information for small businesses as an open question.

One way that small businesses are exposed to new approaches for SCM is when their larger customers attempt to upgrade the business practices of these small suppliers through supplier development, which is a natural outcome from an increasing dependence on small suppliers, as is seen in the automotive industry (Kaufman, Wood and Theyel, 2000). However, such supplier development will be based upon practices that have been effective among OEMs and other relatively large customers (Holmlund and Kock, 1996; Emiliani, 2000; Quayle, 2002). Likewise, a lack of information specific to small businesses in the research literature (Hingley, 2001; Gélinas and Bigras, 2004) limits the value that other sources, such as consultants and academics, can bring to bear on greater formality in small business SCM. We now turn to a description of initial attempts at exploring new approaches for implementing SCM in small businesses.

Experience and Interviews Suggest the Need for New Approaches. One of the authors contributed to the development of a state quality initiative and quality award program, and served as a member of the Panel of Judges and Senior Judge for the award process, which was patterned after the Malcom Baldrige National Quality Award (criteria are available at www.nist.org). This experience highlighted the resource limitations present in smaller organizations.

Among the award criteria is a requirement that there be an effective strategic planning system (Category 2). For large organizations, evidence of such an effort is easily obtained, since there generally are dedicated staff resources, and the process generates a great deal of formal documentation. However, when the award program was adapted to meeting state needs, an attempt was made to make the expectations meaningful for the smallest firms, as well as the larger entrants generally seen at the national level.

When a firm has ten employees, effective planning does not require dedicated staff, nor is it even possible to dedicate staff to such an effort. Further, communication of the results of planning efforts does not require a large volume of formal documentation. In fact, if examiners seek such documentation, it must be for the convenience of the examiner as opposed to an indication of effectiveness, since one of the advantages that a small firm has is that every staff member can be reached immediately by oral communication of plans. In fact, it was found as part of the evolution of the award process that well performing small businesses often had little communication in this regard, since all of the employees were frequently involved in the planning process itself. Thus, examiners needed to switch from looking for artifacts of a planning process to looking for its result, a deployed sense of where the organization was going and why such a direction was important.

Clearly, any attempt at promoting planning among such businesses would better focus on planning approaches and deployment through engagement than on the generation of planning documents. Likewise, the criteria require process management aimed at continuous improvement of all work processes within an organization (Category 6). It is within this category that management of supplier relationships is anticipated. However, if we again look at a firm employing ten individuals, it is unlikely that there will be a supply management department with formally documented procedures for managing these relationships. In fact, there won't be a supply professional either. In such cases, the process will not be subject to as much documentation as in larger firms, but the absence of formality does not mean that there is not a process, or that the process has not been subjected to process management.

Among the smallest firms who applied for recognition, the most effective organizations could describe the importance of supplier relationship management and how the process of such management was a shared process that had grown and developed as members of the organization came to recognize its importance. Most importantly, award-winning organizations could point to results in terms of supportive relationships with suppliers and impact on profitability.

Small firms that could reach such lofty levels of performance are exceptionally rare. To the extent that firms through their experiences found that they needed to manage supplier relationships and developed approaches to doing so suggests that research seeking to establish the best practices currently displayed among small businesses with respect to supply management may prove valuable, although assembling the information may prove challenging, given the experience of the authors.

The authors have extensive experience with small organizations, including ownership and a number of managerial roles. Further, as academics, the authors continue to work in roles supporting development of small businesses, including advising one state's small business development center (a program funded by matching grants from the U.S. Small Business Administration, and present in each state). In attempting to characterize supply management among small businesses, more than 30 years of experience suggests that effective supplier relationship management may be exceptional indeed, given a general lack of basic purchasing practices. In general, experience suggests that purchasing may be retained as a task conducted by the owner in the smaller firms, and that such firms generally lack policies and procedures regarding purchasing.

A lack of formality in this regard comports with previous observations, but many of the organizations within the base of experience lack even basic informal directives. Further, most purchasing within the smallest firms focuses on meeting immediate needs, and is conducted without long-term planning, thus preventing proactivity and aggregation in buys. To the extent that supplier relationships are managed, it generally is the result of personal relationships with particular suppliers or a tradition of buying from a given supplier as opposed to a supplier selection process.

Given a tendency toward owner conduct of purchasing, it should not be surprising that our experience suggests that most of the smaller firms lack training for the person doing the purchasing and that there is little understanding of the current state of purchasing and supply management knowledge. Further, while many firms in our experience recognize that they are not managing purchasing and supply management in the same way as other organizations, they frequently are surprised to find the extent to which they lag more advanced organizations, including the highest performing of their peers.

The authors have conducted numerous interviews with small business counselors. Findings from the interviews supported the contention that in the smallest firms, tactical purchasing was generally the focus, and its conduct was generally retained by the owner. Even in larger organizations, major purchases are almost always made by the owner. It was not clear where the break between firms that developed specialized purchasing and supply management functions and those that did not occurred, either in terms of the number of employees or in terms of revenues, although this specialization was a common feature in the largest of the small firms with which the sample consulted.

Informality and a lack of professionalism dominated the evidence of supply management practices evoked among those interviewed. Further, even these professional business counselors generally questioned the need for advances in supply management among small businesses. There is little evidence that small businesses are aware of the value of professionalism in supply management, or that even relatively sophisticated business counselors routinely suggest development in this realm.

Additional Challenges. Among the several challenges facing smaller organizations compared to larger ones are the issues of focus and attention. Not infrequently, the purchasing function in smaller organizations is viewed as a reordering activity. When evaluating the evolution of firms from entrepreneurial start-up, purchasing is often the last function released by the founder. Major purchasing decisions (and minor ones, as well) are often made by the founder.

The authors have observed numerous occasions where the founder insists on signing every purchase order – even for just a few dollars. When the function is finally released by the owner to an employee, the decisions about what to buy and from whom are already made. Purchasing is, in many senses, the stereotypical clerical function. Entrepreneurs tend to be technical experts with perhaps a traditional business exposure to marketing, finance and accounting, but rarely have they had an introduction to purchasing or supply chain management. It is not surprising that they fail to appreciate the profit and competitiveness impacts of professional supply management. The twin challenges of this situation are first, to educate senior management of small organizations in the professional approaches to the function taken by larger firms and the reasons for them. Second, once an understanding is in place, a strategic focus needs to be developed. As an appreciation for the long-term competitive influence of supply management is developed, resources may be made available.

In a typical manufacturing organization, fifty to seventy percent of every sales dollar is spent by the purchasing organization. It is difficult to argue that a function that represents a majority of a firm's costs should not be a core competency.

REFERENCES

Bresnen, M. and Fowler, C. (1997). "Between a rock and a hard place? Medium sized firms in manufacturing supply chains." *Management Research News,* 20(2/3), 53-54.

Chapman, S.; Ettkin, L.P. and Helms, M.M. (2000). "Do small businesses need supply chain management? *IIE Solutions,* 32(8), 31-36.

Cox, A. (2001). "Understanding buyer and supplier power: A framework for procurement and supply competence." *The Journal of Supply Chain Management* 37(2), 8-15.

Emiliani, M.L. (2000). "Supporting small businesses in their transition to lean production." *Supply Chain Management,* 5(2), 66-.

Gélinas, R. and Bigras, Y. (2004). "The characteristics and features of SMEs: Favorable or unfavorable to logistics integration?" *Journal of Small Business Management,* 42(3), 263-278.

Hingley, M. (2001). "Relationship management in the supply chain." *International Journal of Logistics Management,* 12(2), 57-71.

Holmlund, M. and Kock, S. (1996). "Buyer dominated relationships in a supply chain: A case study of four small-sized suppliers." *International Small Business Journal,* 15(1), 26-40.

Kaufman, A.; Wood, C.F. and Theyel, G. (2000). "Collaboration and technology linkages: A strategic supplier typology." *Strategic Management Journal*, 21(6), 649-663.

Knechtges, J.P. and Watts, C.A. (2000). "Supply chain management for small business: How to avoid being part of the food chain." *Hospital Materiel Management Quarterly,* 22(1), 29-35.

Lee, G.; Bennett, D. and Oakes, I (2000). "Technological and organizational change in small-to medium-sized manufacturing companies: A learning organization perspective." *International Journal of Operations and Production Management,* 20(5) 549-553.

Micklethwait, J. and Wooldridge, A. (2004). *The Company: A Short History of a Revolutionary Idea*. New York: Modern Library.

Quayle, M. (2002). "Supplier development and supply chain management in small and medium size enterprises." *International Journal of Technology Management,* 23(1,2,3), 172-184.

Small Business Administration (1999). *The Facts about Small Businesses 1999.* Washington D.C.: U.S. Small Business Administration.

Small Business Administration (2004). *The Small Business Economy 2002-2003.* Washington D.C.: United States Government Printing Office.