Services Supply Management:

THE NEXT FRONTIER FOR IMPROVED ORGANIZATIONAL PERFORMANCE

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The services sector economy is growing in leaps and bounds as more companies outsource business processes and professional services. Survey data obtained from benchmarking research shows that purchasing services is viewed as more difficult than purchasing goods. In addition, while the amount of money spent on purchasing services is growing, the resources to manage the purchasing are not. There are huge opportunities for organizations to improve in this area in terms of cost and value. In particular, many of the resources that are devoted to managing purchases of goods can be reallocated to purchasing services. This is especially true in organizations with well-established methods for managing the cost and value of purchased goods. Developing an outstanding capability for managing the purchase of services could truly be the next frontier for improved organizational performance.

Background

In recent years, services have become increasingly important as the driving force in the U.S. economy. There was a hollowing of manufacturing in the 1980s and 1990s as much was outsourced to Asia, Mexico, South America, and Eastern Europe. Today, service sector business accounts for about two-thirds of U.S. gross domestic product and non-farm private-sector employment.[1] The service sector accounts for about 80% of U.S. economic growth.[2] Yet, from a practical standpoint, the emphasis in purchasing and supply is still highly skewed towards the manufacturing sector.

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Historically, the service sector has received less attention than the manufacturing sector because the U.S. economy was built on the manufacturing and farming sectors. During the last half century, the importance of marketing specifically for services has been growing. Numerous textbooks have been written on the topic, such as *Services Marketing* and *Services Marketing: People, Technology, Strategy*.[3] Several prestigious academic journals exist today specifically to advance services marketing theory and practice, including the *Journal of Services Marketing* and the *Journal of Service Research*. While services have more recently become an area of focus in operations management, very little work has been done in service supply chain management.

Within supply chain management, this lack of attention extends to the purchase of services. Services may be more difficult for people to visualize and to measure. In general, "service-level agreements" and "statements of work" have not been as precise and finely tuned as specifications for manufactured goods. There is a general belief that *service* quality and performance are not as easy to measure and specify objectively as *product* quality and performance. Thus, service suppliers are frequently relied upon to create the statements of work. These factors have added to the mystique of buying services and have slowed progress in research related to improving services management. This has also created an opportunity for savvy marketing and sales people to take advantage of those who aren't able to articulate their services needs (or are simply uncomfortable purchasing services) by selling them more or different services than they actually need.

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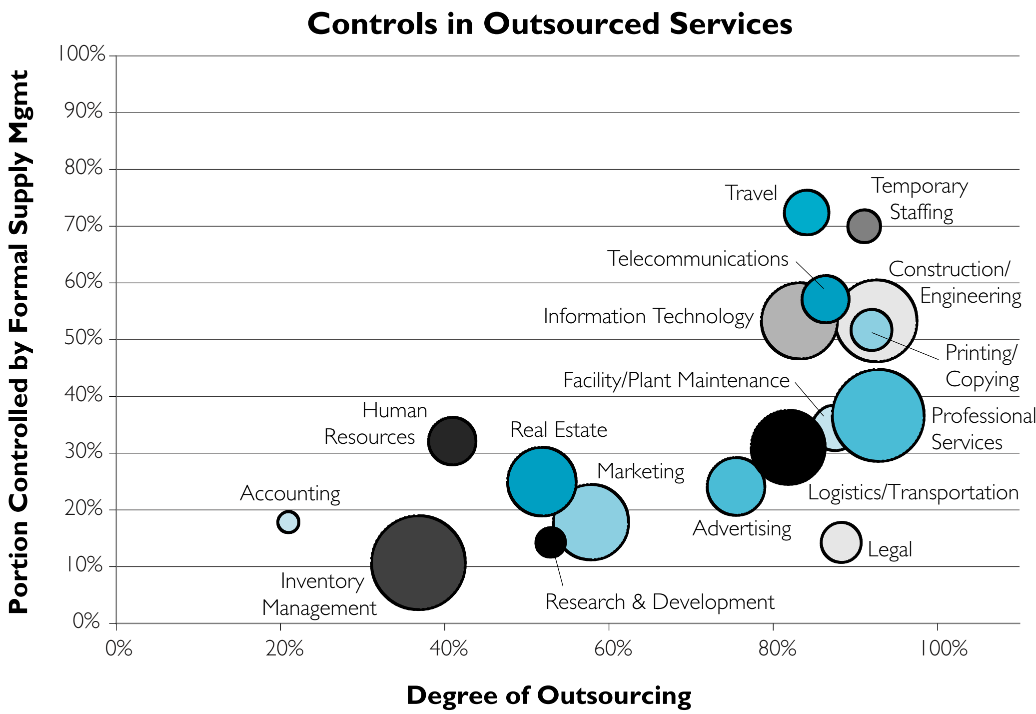
This article uses data from a recent CAPS Center for Strategic Supply Research Study to illustrate some of the problems with the way that many organizations manage services purchasing today.[4] The study investigated current trends in services supply management and included responses from 163 organizations located primarily in the United States. Survey respondents held positions in supply management across a number of different industries, in both public- and private-sector firms.

The Scope of the Problem

Another recent CAPS Research study, entitled "Indirect Spend,"[5] indicates that there are many types of service purchases in which supply management has limited participation, as seen in Figure 1.[6] The size of each circle represents the relative amount of spending. The areas of limited participation include: real estate, legal, facilities, and advertising. Within these areas of limited supply management participation, the parties that use the services within the organization

FIGURE 1. Supply Management Involvement in Services Purchases



generally procure services for their own purposes without the benefit of an established purchasing process or input from supply management professionals. Data show that there is a strong belief that purchasing services is more difficult than purchasing goods, with 69% of supply management professionals surveyed indicating that purchasing services is "difficult" to "much more difficult" than purchasing goods (see Figure 2).[7]

The standard process for purchasing of goods involves five steps as shown in Figure 3.[8] In practice, the number of steps varies, though all of the five key activities must be conducted. This process tends to be very formal for purchasing of goods, with an understanding of the roles that each party plays at each step. Historically, there has not been a similarly standard process for purchasing services.

The marketing literature provides insights into some of the key differences between services and goods that have created the perception that services are more difficult to manage—and are best managed by the user without supply management involvement. Services are considered to be more intangible, heterogeneous, perishable, and inseparable from their source of production.[9] In general, this means that goods are more readily specified and measured than services. The units of measure and the expectations tend to be clearer for goods

FIGURE 2:. Difficulty in Purchasing and Managing Services vs Goods

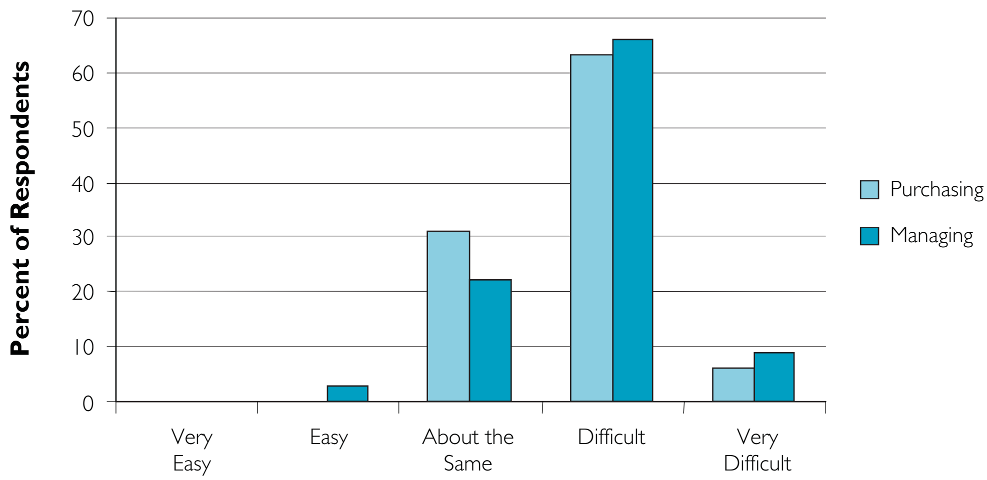
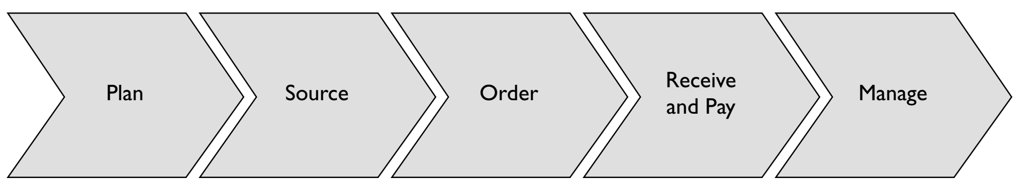


FIGURE 3. The Purchasing Process



Plan: Anticipate the service needed and clarify specifications

Source: Market Research and evaluate potential suppliers

Order: Supplier selection, completion of order process

Receive and Pay: Internal users sign off on completion and authorize payment

Manage: Ongoing measurement to verify compliance and identify improvement opportunities

than services (see Table 1). For example, in the category of heterogeneity, Table 1 shows that quality is easier to pre-specify and measure for goods, whereas quality perceptions for services may be user dependent.

Within the realm of services purchasing, there is also little reference to what others within the company are doing. This lack of a unified approach makes it difficult to understand the true scope of services purchases or to improve the management of services purchases. A decentralized approach without good processes exposes the organization to unnecessary risk in terms

TABLE 1. Characteristics of Goods Versus Services that Add Complexity to Services Purchasing

Service Attribute	Impact of Attribute on Purchasing	Goods	Services
Intangibility	Expectations	Specifications are precise	Vague service level agreements
	Predictability of Demand	Dependent on the accuracy of forecasts for final customer demand	Vary with project scope
	Problem Resolution	Formal processes, clear responsibilities	Lack of set processes, more subjectivity
	Cost	Pre-negotiated, per unit, Easy to determine in advance	Dependent on changing scope and requirements, situation specific, often is renegotiated or changes with scope
	Payment	Match receipts with purchase orders, verifiable	Bills submitted without tangible evidence, pay as you go
	Verification of Contract Completion	Physical Evidence in Shipment	Internal Sign Off
Heterogeneity	Quality	Measurable, Pre-specified	Subjective, User Dependent
	Consistency of Output	Clear specifications, tight quality control.	Services vary with the provider. Broader specifications with a range of acceptable outcomes.
Perishability	Interface Between Providers	Planning and inventory allow for easier transitions	Requires more communication, can't store services
	Inventory Policies	Buffer demand fluctuations with inventory	Buffer demand fluctuations with capacity
Inseparability	Points of Contact	Few points of contact, usually purchasing or project manage. Limited to no customer contact.	Increases the interactions both from a B2B perspective and a B2C perspective
	Physical Separation of Host Firm and Provider Facilities	Physical distance between buyer and seller.	Service is created at point of use, tight coupling.
	Security of Information/Data	High due to physical separation.	More difficult to control due to low physical proximity.

Sources: Adapted From Akkermans and Vos, 2003; Allen and Chandrashekar, 2000; Chase 1981 and 1996, Ellram, Tate and Billington, 2004; Lovelock, 1983; Sampson, 2000, Vargo and Lusch, 2004.

of supplier stability, service supply interruption, and compromise of the organization's reputation, and it may be in violation of Sarbanes-Oxley.[10]

An important problem with the lack of supply management's participation in key areas of services spending is that there are missed opportunities for improved management and control of the services supply chain. Because of the relatively immature state of services purchasing, there is more opportunity to save money and improve processes in services purchases than there is in the purchase of materials. Recent news highlights the potential problems of not controlling and managing the services spending. For example, Price-Waterhouse Coopers, KPMG, Bearing Point, and Ernst and Young recently settled lawsuits, which cost them tens of millions of dollars, for over-billing their clients for travel.[11] Companies such as Hewlett-Packard and others have discovered serious problems with controls and over-billing in a variety of service contracts, including professional services.[12]

These problems would not be significant were it not for the fact that companies spend a sizeable amount of money on services. The 2006 CAPS Center for Strategic Supply Research study respondents reported mean sales of the firms were $5.5 billion with purchases averaging approximately 38.4% of total sales. Purchased services averaged 39% of total purchasing spending, with some firms indicating that their services spending is nearly 90% of their total purchasing spending. Compounding the situation, services spending has been growing rapidly; for numerous firms, services and indirect procurement spending is approximately equal to direct spending and growing.[13]

Outsourcing of professional services such as accounting and information technology is also expected to accelerate rapidly over the next five years and beyond.[14] Further, the growth in offshore outsourcing of services adds to the complexity of sourcing and managing services. Thus, understanding and managing the services spending and the services supply chain will continue to grow in importance in the foreseeable future.

Current Pitfalls in Services Purchasing Management

There are a number of barriers that need to be addressed to improve services purchasing.

Lack of Resources Focused on Services

In the purchase of tangible goods such as components and materials, there are many excellent controls and processes in place within most manufacturing organizations. For example, organizations such as Honda of America Manufacturing, Deere & Company, and Intel build models of their supplier's costs. They have cost engineers and financial professionals who work hand-in-hand with supply management to understand the reasonableness of supplier's quoted cost versus price, and they provide data to facilitate improvement and fact-based negotiations. Materials suppliers are selected in a relatively objective manner and are professionally managed based on data and on-going performance results.

TABLE 2. Average Number of Active Suppliers and Spending

	Direct Materials	Indirect Materials	Onshore Services	Offshore Services
Average Number of Active Suppliers per Supply Management Employee	36	101	105	71
Average Spending per Supply Management Employee (in Millions)	$25	$13	$25	$15

Source: CAPS Center for Strategic Supply Research, 2006.

Because they apply structured cost analytics, these organizations save money year-after-year in the purchase of materials.[15] This focus on cost management of materials is a common approach among leading manufacturers in all sectors, and it has proven to be very successful. Yet few organizations dedicate commensurate resources to improving the purchasing and management of services. CAPS Research data from 2002 indicates that the average buyer of direct materials manages 32 active suppliers, while the average buyer of services manages more than twice that many, 74 active suppliers. In a more recent study (2006), the ratio of suppliers to buyers in services has gotten worse. The average buyer of direct materials is responsible for 36 active suppliers, while the average buyer of domestic services is responsible for approximately 105 active suppliers. Both the buyers of direct materials and onshore services are responsible for an average of $25 million in annual spending. At the same time, services marketing and the bundling of goods and services into "total solutions" is growing (see Table 2).[16]

This dilution of services buyers' time makes it difficult for them to be proactive in managing service suppliers, creating an unending cycle of services suppliers who are not well managed. The dilution of the buyers' time and effort among so many suppliers may also perpetuate the myth that services buyers do not add significant value to the purchasing of services. However, the lack of apparent value-added may be due to a lack of time rather than a lack of capability.

This paucity of resources, tools, and skills within services supply management departments can create expensive problems. As shown in Figure 1, there are many services (such as real estate, marketing, and human resources) where supply management still has limited control and involvement. Services are frequently purchased by the end user, with limited input from supply professionals.[17]

Lack of Information Technology Support

Further, services buyers are less likely to be supported by information systems than direct materials buyers, as illustrated in Table 3.[18] Partially because of the heavy workload and the lack of information systems support, buyers and internal functions may utilize software tools provided by service providers. For

TABLE 3. Use of Software to Support Various Spending Categories

	Direct Materials	Indirect Materials	Onshore Services	Offshore Services
ERP (such as SAP, Microsoft, Peoplesoft, Epicor)	71.3%	66.4%	58.5%	48.0%
B2B or Supply Chain Software (such as Oracle, SAP APO, I2, Manugistics)	36.8%	30.8%	27.7%	16.5%
PSM (such as Ariba, Perfect Commerce, Rearden, SABRE, Chimes)	34.6%	39.3%	36.8%	25.9%
Custom/Legacy	48.0%	39.0%	34.4%	21.7%

Source: CAPS Center for Strategic Supply Research, 2006.

example, package shipping companies and temporary labor firms provide their customers with systems for them to use to purchase their shipping or labor services. Adoption of supplier tools may bias users toward these service providers because of their familiarity with the buying tools. The bias toward particular service providers is just one of the factors that should be considered when determining when it is appropriate to outsource.

Knowing When to Outsource

The theory of transaction cost economics (TCE) provides insight into when firms should perform a task internally versus when it is more economical to outsource a task. TCE advises *against* outsourcing when the firm is at risk of becoming dependent on a supplier because the supplier either has or develops specific assets (such as information and ordering systems) that the firm needs and does not itself possess.[19] TCE suggests that such dependence creates the possibility of suppliers behaving opportunistically through over-charging, reducing services, and generally exerting power over the buying firm. Such dependence also raises the cost of switching suppliers. It seems likely that the availability of supplier tools that are superior to internal tools also encourages internal clients to bypass formal purchasing systems, thereby encouraging rogue spending. TCE also advises against outsourcing in situations of uncertainty, such as when the firm cannot adequately judge whether the supplier is performing as promised or when it cannot clearly specify what it wants in terms of outcomes.[20] It is likely that the supplier-provided tools and systems support the measurement on which the supplier wants the buyer to focus, not necessarily the measures most important to the buyer. This creates further possibility for opportunistic supplier behavior.

Cost Drivers and Structures

Often, there is very limited understanding of the cost drivers and structures associated with procured services.[21] The complexity of service cost structures and delivery models, coupled with resource shortages in services supply management departments, may cause overworked services buyers to depend on the supplier's sales staff and reporting systems to understand costs and cost drivers. Because of misaligned incentives, these dependencies may reduce the administrative cost of the supply management group at the expense of unfavorable prices, producing a higher total cost of ownership.

Fragmented Spending

The decentralized nature of the services buying community ("users") creates an opportunity to place orders with an unapproved supplier or for the supplier to deliver a non-standard service. In contrast, such deficiencies are exceptional when procuring direct materials, due to well-established systems of control such as supplier qualification processes.

With the decentralized and fragmented state of services purchasing, for many service categories less than 60% of spending flows through formal systems and processes. That appears to be improving, as participants in this study[22] indicate that they manage or control approximately 68% of the services purchasing spending. Services purchasing is also more likely to be decentralized or hybrid than direct materials purchasing. The CAPS study indicates that among the firms studied over 50% utilize a decentralized or hybrid approach for services purchasing, in contrast to around 40% that use such an approach for direct material purchases.[23] Decentralization along with increased levels of outsourcing and offshoring create an increasingly challenging job for services supply management staff. Adding this to the fact that many organizations do not have the systems to truly capture the magnitude of services spending outside of the supply management function, it is difficult to build a case for change. There is little incentive for suppliers who are the beneficiaries of this rogue spending to track or report such spending within their systems. Yet buying organizations often rely upon their suppliers to help track services spending. Under such circumstances, a lack of clear service-level agreements—and, ultimately, scope creep—is inevitable, which favors the supplier.[24]

Growing Supply Base

Another symptom of the difficulty service supply managers face is the size of the supply base. Supply base rationalization, generally meaning supply base reduction, has been a common improvement practice in direct materials for the past 10 to 20 years. Supply base reduction creates opportunities to leverage costs, work on improvement opportunities, build internal and supplier relationships, and reduce the administrative burden of managing a huge supply base. Among the firms in the 2006 CAPS study, 58% reported an increase while only 4% reported a decrease in the number of offshore services suppliers.[25] Thus, it appears that there is a movement towards a less manageable rather than a more manageable services supply base. This is likely a product of the decentralized nature of services spending.

Summary of Current Pitfalls

A variety of factors contribute to the current state of relative neglect of professionally managed services purchases. These include everything from lack of resources and information technology to support improved services purchasing, to lack of understanding of when to outsource, and lack of understanding of cost structures. Coupled with fragmented services spending and a growing services supply base, the results of poor services purchasing management can have harmful affects on the organization's performance.

Outcomes of Poor Management of Purchased Services

The negative results of poorly managed purchasing spending are both financial and non-financial in nature, and harmful to the overall performance of the firm.

Financial Implications

To get a better understanding of the implications of not properly managing services, a financial services company reported, after extensive auditing, that their actual temporary labor prices were 6.2% higher than contracted. This range is typical of procured services. CAPS data shows that procured services typically account for 39% of total procurement expenditure, and 14.6% of revenue.[26] It is not unusual for procured services to represent more than 60% of a firm's revenue.[27] Using these data, a typical firm could expect over-billing in services procurement to cost them around one percent of *total revenue* (6.2% over-billing * 14.6% services spending as a percentage of revenue). For a company with a 20% profit margin, this one percent loss of revenue is equivalent to nearly a 5% loss in total profit (see Table 4). This has significant profitability implications. This amount is material in virtually all organizations, and it would be addressed aggressively if the loss potential were transparent.

TABLE 4. Example of Financial Implications of Improper Management of Services (000's)

$10,000,000	Total Revenue
$ 1,460,000	Services Spending (14.6% of Total Revenue)
$ 90,520	"Unearned" Excess Services Billing (6.2% of Services Spending), equivalent to lost profit
$ 2,000,000	20% Profit Margin
4.53%	Profit Reduction due to Excess Services Billing (90,520/2,000,000)

Opportunistic Supplier Behavior

Following are examples of behaviors that services suppliers exhibit that result in economic loss to their customers. As posited by TCE, suppliers may behave opportunistically in situations where the buyer has limited information or cannot detect that the supplier is taking advantage.[28] For example, suppliers can usurp procurement leverage by keeping rebates and special pricing themselves and by diverting available stocks in times of shortage, the benefits of which otherwise would have been captured by their customers.[29] An example reported in the Wall Street Journal[30] and elsewhere[31] indicated that the U.S.

government and others filed suit that certain audit firms systematically "billed clients full fare for airline tickets, hotels, and car rental, while pocketing undisclosed rebates and volume discounts." Another related behavior is for consulting firms to arrange with airlines to charge higher prices for "client paid" and significantly lower rates for "non-client" travel. There is a high level of complexity in many services contracts. This makes it difficult to clearly specify the service-level agreements and control the large number of loopholes that exist in services relationships.[32] Given the wide scope of responsibility of services buyers, it is little wonder that most services supply management groups are unable to adequately protect their supply chains.

Another challenge for services supply management departments is ensuring that what was contracted for is actually delivered. This gives rise to a further type of common opportunistic supplier behavior, replacing more capable labor with less capable. This behavior is typically very hard to specify, detect, and prevent,[33] especially given that many services supply management departments are understaffed. Substitution can often increase risks to the buyer, which is also difficult to measure. For example, reducing the staff quality of a software project will often lead to project delays and cost overruns. These expenses are rarely perceived as a cost caused by a defect in the supply management process.[34] While the marketing literature warns that opportunistic supplier behavior can damage ongoing buyer-supplier relationships,[35] such behavior often goes undetected today.

Process Flaws

Other costly supply management process defects are caused by the common practice of summary invoicing for services.[36] Unlike direct materials that can be controlled via three-way matching (invoice, purchasing order, receiving documents), services are often controlled using a two-way match (invoice and purchase order) with summary invoices lacking objective, physical evidence of delivery.[37] Summary invoices, which provide few details of activities performed, are used to reduce the resource burden in the services procurement and accounts payable groups at the risk of increased costs.

The examples offered above are not unique to service providers. However, the lack of formal processes to oversee services exacerbates the problems and allows them to remain undetected and uncontrolled. In many cases, these behaviors can be mitigated by increasing the resource base of services supply management departments and adopting better tools and processes. In some situations, the loss of economic value appears as higher than warranted pricing. However, the loss of value may also occur due to failure to secure non-monetary advantages and the burden of increased risk. Controlling these service supplier behaviors during the supplier selection, contracting, and delivery management phases can be time consuming and expensive, but they are more expensive to ignore in the long run.

Summary of Risk Implications

The previous sections on pitfalls and outcomes highlight the risks involved in purchasing services today. Risk is defined in many ways and generally encompasses negative outcomes or the factors that lead to negative outcomes.[38] As mentioned above, risk factors associated with buying services may include hidden costs, contractual difficulties, diminished quality of services, and increased cost of service. Some dynamics that lead to these risk factors include a lack of knowledge of the intricacies of the activity, a lack of experience in managing the activity, opportunistic behavior by the supplier, measurement problems, and asset specificity.[39]

In some situations, it may be necessary for the buying company to assume some risk to reduce costs. For example, when the costs of contracting for contingencies associated with transaction uncertainty are high versus the perceived loss potential, the buyers may choose to face the potential consequences of problems after the fact.[40] In other situations, it may be prudent to reduce risk through accurate delineation of expectations in service contracts.[41] As predicted by TCE, transactions with perceived greater size, specific assets, uncertainty, and complexity give rise to more extensive written contracts[42] and therefore a clearer delineation of expectations to the supplier. There is evidence in the contracting literature related to both goods and services that characteristics of transactions and the characteristics of the transaction partners are related to the extensiveness and the structure of the contracts.[43]

Barriers to Improving the Services Purchasing Resource Bind

A failure to reallocate resources to functions where they can be used most effectively has been documented in numerous organizations. A possible cause, called “the contingent power model,” is recognized in the organizational design literature.[44] The basic premise of this model is that organizations adapt imperfectly to organizational threats. When an organization faces an environmental threat, it promotes and provides resources to people who can address the threat. These individuals consolidate and reinforce their positions within their organizations, creating a power base that has a bias towards individuals with similar skills. Unfortunately, once the environmental threat has diminished, these individuals may refuse to relinquish power and resources, limiting the ability of the organization to address future threats. Historically, supply management resources have focused on purchasing direct materials. Such empire-building behaviors, though human, cause firms to be slow at mobilizing resources to address new challenges, such as the rapid rise of services and outsourcing.

For example, when faced with significant legal challenges, a company will often appoint a lawyer as their CEO. The legal department then has increased stature, power, and resources that allow the firm to address its legal challenges. A difficulty is that the CEO may not see the need to step down in favor of someone with skills that can address the firm’s next challenge. This same phenomenon could be blocking the movement of appropriate resources to services purchasing.

Reliance on a Flawed Competitive Bidding Process

While a competitive bid sourcing process can provide good insight to the current market pricing for a predefined service, it rarely provides insight into the underlying dynamics of the supplier's cost structure or the relative costs of the various activities the supplier is taking on. In essence, competitive bidding may tell you what a service *does* cost, but it does not tell you what a service *should* cost.

This lack of visibility to the inner workings of a services supplier leads to limited, win-lose negotiations, typically focused on price and market competition alone. Price-only negotiations stem from the premise that a supplier's operation is efficient and that supply management's value-add is focused on identifying the most efficient supplier by eliminating the "excess profit" from supplier proposals. This approach is short sighted, particularly when procuring services, and ignores the very real fact that suppliers incur costs for (and charge for) certain activities that may not be relevant or even add value to an organization's specific situation. Focusing on price without understanding the underlying cost drivers can cause supply managers to sacrifice important value, increasing costs when the contract must be renegotiated later.

Lack of visibility and control may result in the firm not getting what was paid for or in getting a competitively inferior price. The firm may lose the opportunity for effectively exploring alternative sources when users are strongly influenced by the service providers. Lastly, lack of adequate resources and processes may prevent firms from fully exploring supplier's ideas to improve service delivery, value, and cost, thus losing potential advantage.

Resistance to Supply Management Involvement by Budget Owners

When presented with all of the evidence that services purchasing is managed improperly, it is possible that some enlightened groups will welcome supply management participation to support the purchase of services. Other functions may not. They may see supply management involvement as a way to usurp their budgetary freedom. Supply management needs to be flexible in the way that it participates with key internal stakeholders. What is the type of support that the stakeholders need? How could they benefit from direct supply management involvement in the areas in which they are spending their budgets? The model for the most effective involvement in services purchasing may not mirror the model for the most effective involvement in purchasing direct materials. For example, Bank of America reports that supply chain management is involved in 100% of their services purchases.[45] Why? Bank of America views supply management (referred to as "supply chain management") as performing an essential, value-added service. The internal user must build a business case for why it needs to make a major purchase. Supply management provides support in terms of supplier identification, contract development, and creating a model for supplier management. Supply management provides training to the internal user, who then performs the day-to-day management of services suppliers. Thus, supply management does not simply "take over" services purchasing. Each function uses its strengths to support services purchasing and supplier management.

Putting Things Right: What to Do

While there are a growing number of examples where services supply management is viewed as an important activity, and is supported by sufficient resources, there are still many opportunities for improvement at most organizations. We have six main suggestions on how to improve the services supply management. These should be implemented roughly in the order in which they are presented. However, some steps may have to be revisited.

Step 1: Understand the magnitude of the services purchasing spending.

The first step is to understand the organization's total services spending. This should consider:

- total spending by category;
- which business units, functions, and individuals are spending their budgets on services;
- where the services spending is being approved; and
- the level, nature, and timing of supply management participation in the various spending categories.

As is true with any change, data are required to support the potential opportunity for improvement. If it appears that the spending is already being consolidated across businesses, and that supply management has heavy involvement early in the purchasing process, things may be in good shape at your organization. There may be a small number of categories that still need attention, but you may be well on your way to a professionalized services purchasing approach. If you find that supply management feigns involvement, but really just signs off on decisions that are already made by budget holders, there is likely significant opportunity for improvement in both costs and your organization's level of risk exposure. This information is essential before proceeding to the next step.

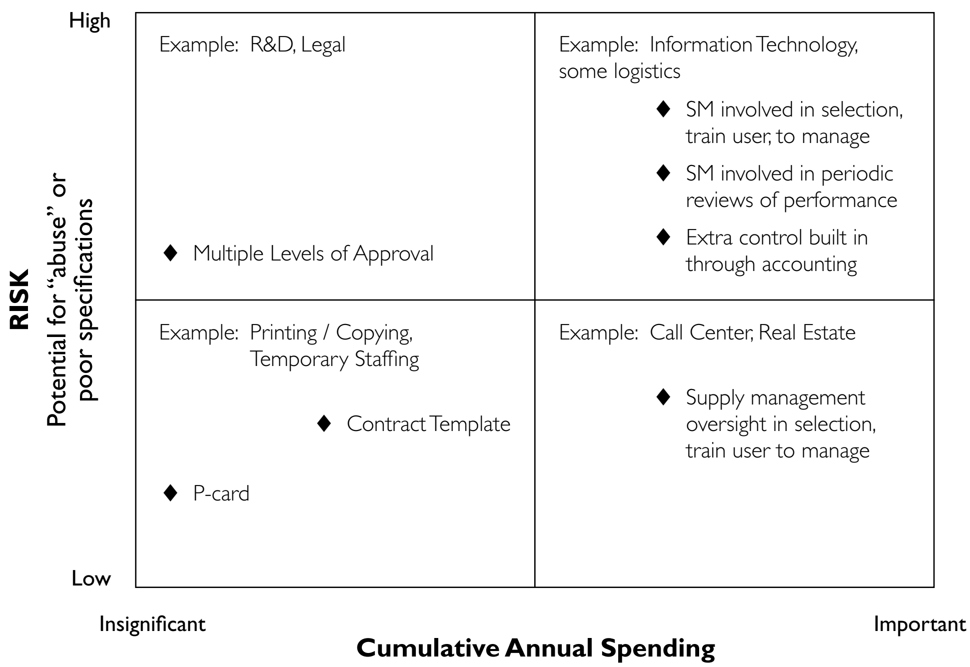
Step 2: Segment the purchasing spending based on value and risk.

In the realm of purchases of direct materials, not all purchases are of equal importance, so not all receive equal attention and management. The same holds true in the realm of services. The users of services possess a certain level of expertise regarding their needs, a level of expertise that a buyer might not have. On the other hand, a buyer should have an expertise regarding the buying process, supplier management, and creating proper supplier measurement and control systems. The relative expertise of both parties is shown in Table 5. A suggested framework for determining the relative involvement and input of supply management versus the internal user is shown in Table 6 and Figure 4. The importance of each of the steps varies depending on what is being

TABLE 5. Relative Expertise of Supply Management Professionals and Internal Services Users

	Supply Management Professionals	Internal Service Users
Providing a comprehensive, competitive process for managing selection	• Bring discipline to process • Objective third party • Integrity • Consistency in analysis methods	• Deep understanding of true needs
Plan: Identify opportunities/sources	• Identify multiple qualified sources to consider • Source/qualify supplier • Educate management/team on importance of choosing right supplier as well as ongoing analysis	• Knowledge of some key suppliers and past performance issues • Articulate needs, including timing, duration, specific skills
Source: Aiding in selection of sources	• Run competitive process • Market analysis • Qualitative and quantitative issues • Understand true cost picture/total cost of ownership	• Provide major input into supplier selection criteria • Major voice in selecting supplier
Execute: Developing and negotiating the contract and ordering	• Commercial skills • Negotiate relationship breadth/services/performance • Contract process/management • Gain sharing arrangements	• Provide specifications for contract terms related to service performance
Receipt and Payment	• Specify in the contract the terms and conditions under which payment occurs • Work with Accounts Payable and users to set up payment system that conforms to contract, with proper controls	• Supervise/benefit from the work performed • Ensure that work is performed to contract before approving payment
Manage: Identifying potential relationship issues and ongoing monitoring/ management	• Set up measurement process and systems • Identify potential benefits and risks • Train user to identify issues and manage the supplier • Manage supplier relations if major issues arise • Manage strategic risks • Support "re-sourcing" relationship if needed	• Manage ongoing relationship • Provide supplier performance feedback • Manage the operating risks communicate with supplier • Manage day-to-day supplier relations

FIGURE 4. Ideal Management of Services Purchases



purchased. For low-dollar, low-value items that are infrequently purchased, it is probably not cost-beneficial to do an extensive search and analysis of suppliers. The best way to manage these items is to have a standard services contract template available on-line for users and to have the users select the supplier and manage the contract themselves.

Once the purchase exceeds a certain dollar threshold determined to be significant by the firm, or once there is a certain level of perceived risk or improvement opportunity associated with a purchase, supply management should begin to play a role (see Figure 4 and Table 6). The depth and breadth of that role varies with the situation.

For example, in virtually all situations where it is cost beneficial, supply management should be involved in the plan and source steps, and the majority of the execute step, providing both process knowledge and supply market research knowledge. Supply management will work with the user on creating the right ordering system and on communicating to the supplier that it has "won" the business. The user must do the actual receiving of the service and authorize the payment. The user is often in the best position to know whether the supplier really performed to the contract or not. Supply management can also assist the user in developing metrics to assess supplier performance and provide training to users on giving suppliers feedback and managing the relationship, stepping in only as needed when the user has a situation he or she

TABLE 6. Relative Involvement of Supply Management and Internal User Based on Type of Purchase

	Example	Overall Process Identification	Identify Need/Sources	Selection
Very Low Value, Low Risk	Printing/ Copying	Use purchasing card (p-card)	User	User
Low Value, Low Risk	Temporary Staffing: Special, Short-Term	Supply Management (SM) provides contract template	User	User
Higher Value, Low Risk	Real Estate, Janitorial, Call Centers	SM provides process	Both	User, with SM input
High Value, High Risk	Information Technology, Some Logistics	SM provides process	Both	User, with SM input
Low Value, High Risk	R&D, Legal	SM provides process	Primarily user, SM is warranted	User, with SM input

cannot manage. This approach also fits well when the supplier relationship does not span multiple businesses and budgets.

When the organization is dealing with a service that spans multiple business units, a team or "purchasing council" approach is generally warranted, with user participation from the concerned budget areas. A difference to the process presented immediately above is that the individual users would provide management of the supplier representative(s) with whom they interact. All the supplier performance metrics would be rolled up across businesses, with a "corporate" level relationship with the supplier as well. This overall relationship could be managed by supply management or by the purchasing council made up of users, with support from supply management as needed.

Step 3: Allocate appropriate resources relative to economic return to the area of services supply management.

Based on the findings in the first two steps, the conclusion may be that services purchasing is poorly managed, and the right level or type of staffing is lacking. Now it is a matter of setting priorities. Looking at the spending analysis in Step 1, which are the biggest categories of services spending? Which are the most fragmented? Ideally, finding a spending category that is large, fragmented, and not extremely controversial is a good place to begin your services supply management transformation. An example of an ideal service might be contingent labor for office support that is currently purchased on a site-by-site basis. This will create an early success, which will pave the way for involvement in

TABLE 6. Relative Involvement of Supply Management and Internal User Based on Type of Purchase (continued)

	Contract Development	Receipt & Payment	Ongoing Mgmt
Very Low Value, Low Risk	User	User	User
Low Value, Low Risk	User, with SM template	User, following SM established procedures	User
Higher Value, Low Risk	SM, with user input	User authorize according to contract	User manage day-to-day; SM manages overall relationship, leverage
High Value, High Risk	SM, user input	User authorize according to contract	User, with SM oversight to review risk position and manage leveraged aspects of contract
Low Value, High Risk	SM, user input	User authorize according to contract	User, with SM oversight to review risk position

other areas. This approach has been successfully undertaken by numerous companies as they transform their services supply management. Clearly, improvement will be limited without the right level of and type of staffing. In most cases, improving services supply management will be an incremental process whereby supply management proves itself and is thus awarded more resources.

Step 4: Increase the professionalism of the services purchasing area.

In some ways, this means making the handling of services purchases more like the handling of materials purchases. This includes creating service "should-cost" models, similar to lean manufacturing. This takes time. Organizations should begin in areas where they have some information and they believe that there is opportunity to improve. These models should be used for benchmarking services supplier quotations and opening a dialogue with services suppliers about services cost and value improvement. Top management support is also needed here to disallow services purchasing without the involvement of service professionals to help develop contracts, service-level agreements, and supplier performance metrics. This top management policy has supported the success of supply management involvement in services purchasing at Bank of America and other firms. As presented in Step 2 above, the organization must segment services purchases by risk and value, and focus on where supply management can add value, versus involvement for involvement's sake.

Step 5: Measure effectiveness and ensure proper business controls.

This is a matter of getting the right tools developed and in place. It includes conducting periodic supplier audits to correct compliance errors. Such audits should not simply be punitive, but should address the underlying issues that create the errors. As indicated earlier, services purchases are much less likely to be supported by internal information technology than materials purchases. Organizations should install systems to inspect services transactions to control compliance errors, as they have done for materials. In addition, many organizations would benefit greatly from developing better services contracts that include elements such as specific payment milestones, clear service-level agreements and measurements, and clear delineation of the meaning, causes, and penalties of non-compliance.

Step 6: Put the best people in services supply management.

Without this commitment to getting the best people in services supply management, failure is inevitable. Any organization needs some trailblazers to set the standard, people who know what is possible and can develop a vision for formalizing services. Leveraging existing, experienced materials buyers to apply their skills to services purchasing is one alternative. Hiring from other companies and industries that have effectively taken control of services purchasing is another common alternative. The key is to begin to take steps to better manage services spending. Dedicating skilled resources to establishing new systems for better managing the purchase of services should result in a tremendous return on investment and improvement in value of services for the dollars spent. Purchasing of services could truly be the next frontier for improved supply chain and organizational performance.

Benefits

The potential benefits of increasing the professionalism and support for services supply management are numerous. Supply managers are professionally trained in processes to best understand the requirements for a purchase; develop these requirements into clear statements of work; identify, screen, and select suppliers who can meet those needs; and then manage and measure these suppliers. Bringing a sufficient number of supply management professionals into services purchasing can help the organization to increase the value it receives from its services purchasing spending. Professionally trained salespeople are skilled at selling more services than people really need. An objective third party, like supply managers, can help prevent this overbuying and associated overspending while working to ensure that real needs are met. In addition, professional services purchasing should reduce the organization's risk exposure, putting the company in compliance with that aspect of Sarbanes-Oxley.

There is also the potential for substantial cost reduction simply by catching errors that result in over-billing. Further cost reduction may be forthcoming by reducing the supply base and leveraging purchases from the best available sources, across businesses. As a company gains leverage and visibility as a customer, there is increased opportunity for improved customer service. Better buyer-supplier relationships may be pursued as the buying and supplying firms become more important to each other. Due to improved supplier relationships and better visibility, services supply management may develop a better understanding of services costs and work more effectively with services suppliers to improve the cost of services purchases.

Increasing professional supply management involvement in services purchases will also improve the level of accountability for services spending. When business units realize that there are corporate policies for executing and managing services spending, they are likely to control their own services spending more carefully. In order to develop clear statements of work, business units will need to clearly define their own requirements, which forces a more thorough review and understanding of actual needs.

Conclusions and Future Directions

As services continue to increase in importance to the organization, there is a tremendous opportunity for organizations to improve their services supply management by dedicating more resources—and the right resources—to services purchasing. Supply managers can improve cost controls, minimize value leakage, and assure that firms are receiving more value as well as competitively priced offerings. Skilled personnel should be shifted to services purchasing from areas of direct materials and component purchasing that are currently under control and well managed. This shift is needed in order to leverage the expertise of experienced buyers in managing cost and value, as well as their ability to establish new systems to better manage the purchase of services. The reallocation of these skilled resources will likely favorably impact the firm's return on investment as well as improve the value of services for the dollars spent.

Marketing and sales are years, if not decades, ahead of supply management in terms of identifying the unique potential and value of viewing and selling services differently than goods. Supply managers have been left out of the services purchasing group in part because the sales forces of services firms have been successfully selling directly to the users. Yet, when supply management was brought in to the process for purchasing marketing services at a large consumer products firm, it was able to *reduce service costs* by 30-50% in some areas simply by unbundling services and bringing in competition. Supply management provided the purchasing process expertise, while marketing played the role of subject matter expert and on-going relationship manager.

Lack of supply management involvement in services supplier identification, screening, and selection exposes the organization to new risks. Is the supplier financially viable? What does the organization know about the supplier's parent company and other customers? Is there a potential for conflict of interest? Does the contract adequately protect the buying firm from liability? Sarbanes-Oxley requires that companies have such knowledge of their key business partners. Clearly, this by itself is a call to increased attention to services buying.

Universities should also give attention to the service sector and services supply management in educating future practitioners and in conducting research. The area of services supply management affords great research opportunities. Currently, many firms are showing a strong shift toward offshoring services. Organizations and researchers need to consider whether offshoring will further compound the current problems with services control. It is important for firms to understand the impact that services supply management has on their profitability and their competitive advantage. This should not be a backroom operation, or left to chance. Successfully managing services buying is a new frontier, and it may be the next leap in improved supply chain and organizational performance.

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