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BEST PRACTICES IN SERVICES PROCUREMENT

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ABSTRACT

Due to globalization, outsourcing and recent economic events, the services sector has gained increased importance in the global economy. Correspondingly, the field of supply chain management must evolve immensely to accommodate and understand the nuances of service supply chains. Despite the high level of spend attributed to services, most existing academic research in the field exclusively describes the processes involved in the manufacture and distribution of goods. Without academic guidance, service supply chains and their respective procurement organizations have been challenged to combat decreasing margins through strategic purchasing decisions and cost reduction. In this research, six companies were studied and interviewed about their respective practices in services procurement. The respondents shared their general perceptions and experiences in supplier selection, relationship management, contractual agreements and performance management. Their challenges, goals and operational procedures observed in these six procurement organizations were compiled to determine best practices in the developing field of services procurement. In general, this research determined that procurement organizations should align incentives with service suppliers through long-term relationship development, performance-based contracts and detailed statements of work with measurable deliverables.
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Chapter 1

Introduction

To most people, the term “supply chain” evokes an image of goods traversing through manufacturing lines, distribution centers and storefronts. Textbooks, professors and academia as a whole tend to focus on traditional topics such as inventory management and factory dynamics. Although the production of goods is a crucial component of many supply chains, the world economy has evolved over time; as the manufacturing sector continues to be outsourced to low-cost production areas such as Asia and Eastern Europe, services have assumed a greater role in the marketplace (Ellram, et.al., 2004). In 2012, 79.2 percent of the United States’ GDP derived from the services sector with manufacturing and farming sectors composing the remainder (“United States,” 2014). This trend is predicted to continue with an economic upturn and increased employment in the services sector. Despite the commercial importance of services, the topic of service supply chains has been relatively underexplored.

According to the Bridgefield Group, a supply chain consultancy, the term “supply chain” can be defined as “a connected set of resources and processes that starts with the raw materials sourcing and expands through the delivery of finished goods to the end consumer” (Janvier-James, 2012). Like many other definitions, Bridgefield’s description applies primarily to the manufacturing sector and omits the concepts of information flow and services. Beyond simple definitions, a dichotomy exists between the availability of information detailing the two formats of supply chains; while a shortage exists for services, ample research is available in manufacturing. Although many supply chain practices used in manufacturing can be applied directly, there is one key difference between goods and services: the element of human labor.
Rather than purchasing a final product, in the case of services, the customer requires a particular type of work to be performed. This distinction adds complexity to every node of the supply chain. In particular, the procurement and purchasing of external services has proved challenging to many businesses.

Across all industries, firms outsource services to simplify operations. Most companies tend to focus efforts on their core competencies and employ others to do the rest. Although these services range in technicality and importance, from maintenance to subsea engineering, the purchase of these services is crucial to any business’ success. Typically, procurement professionals are tasked with the selection and management of these providers. Depending on the company’s size and procedures, this process varies widely in complexity, but can include managing contracts, work requests and performance metrics. Presently, limited information exists for companies aiming to improve their purchasing departments due to the lack of research in the area of service supply chain management. Accordingly, this research will examine current methods in the field by interviewing a convenience sample of six services procurement professionals from varied industries and backgrounds. The ultimate goal of this research is to determine best practices in services procurement so that companies can better manage this unique type of supplier.
Chapter 2

Background

Supply Chain Management & the Service Industry

In recent history, supply chain management and its relevant processes have become increasingly important to businesses looking to remain competitive in an ever-changing marketplace. Drivers such as outsourcing, globalization and decreasing margins and have pushed organizations to continuously improve and develop supply chain competencies (Baltacioglu, et.al., 2007). Accordingly, the amount and depth of research performed in the field has increased exponentially for the past two decades or so. Although a multitude of information is now available through academia, journals and case reports, the majority of content focuses primarily on manufacturing, with little information that addresses the service industry.

Along with other causes, this gap is primarily attributed to “the fact that world economies were built on the manufacturing and farming sectors” (Giannakis, 2010). In almost all developed nations, a gradual shift has occurred; after economies achieve growth through manufacturing, services become increasingly prevalent. Nevertheless, even in advanced economies, service supply chains are just beginning to gain traction. Like any other business, service providers and purchasers are constantly seeking ways to improve their respective supply chain strategies, designs and processes. Currently, due to the shortage of relevant content, the manufacturing industry is superior to services when measured on supply chain performance and process efficiency (Giannakis, 2010). In order to make a fair comparison, it is important to note the inherent differences between manufacturing and service supply chains.
While supply, production and delivery of goods forms the basis of a manufacturing value chain, the key component of a service network is human labor. In a way, this makes the manufacturing process less complex because the production of tangible goods is better suited for “standardization and centralized procedures and controls.” Most manufacturing companies rely heavily on these requirements, abiding by strict tolerances and specifications. In the case of services, a very intangible product, these decisions occur in a decentralized manner; “variation and uncertainties in outputs are higher because of (...) human involvement” (Sengupta, et.al., 2006). The concept of intangibility is one of the main differences between these two sectors. Baltacioglu, et al., explain, “Services cannot be seen, touched, smelt or tasted, as they are performances rather than things” (2007). Because human performance is affected by infinite factors, ranging from training to morale, its management and standardization is extremely challenging. Conversely, the customers’ notions of value and service quality will differ in every environment. For example, while it’s relatively simple to identify a defective part, poor performance of a service is more difficult to measure or even to identify.

Beyond the nature of the two products, focus areas differ across manufacturing and service supply chains. While service networks concentrate efforts on “management of capacity, flexibility of resources, information flows, service performance and cash flow management,” manufacturing firms take a very different approach (Sengupta, et.al., 2006). In addition to tangibility, three other key characteristics differentiate services from goods: heterogeneity, perishability and inseparability. These four attributes alter the service supply chain and especially purchasing in many ways, ranging from payment schemes to inventory policies. Heterogeneity refers to the aforementioned fact that services cannot be easily standardized; every customer experiences a different service, every time it is received based on perceptions and past experiences. Perishability is inherent because if “a service is not consumed when available, then there is no chance to stock it for future use. Unused capacity is lost forever.” Lastly,
inseparability “reflects the fact that customers must be present for the service to be provided. In a service setting the customer usually contributes to the production process, and once the production is realized it is followed by instant consumption in a simultaneous manner” (Baltacioglu, 2007). See Appendix A for a complete analysis of the four main differences. Despite the aforementioned distinctions, some supply chain concepts can be utilized across all industries, such as demand and supplier relationship management. In the spirit of continuous improvement, best practices and academic recommendations in these categories should be applied from manufacturing supply chains to services and visa versa.

The Economic Importance of the Services Sector

As a basis for this research, it is important to realize the importance of the services sector to the United States’ and global economies. Although most economies were built on production and farming, there has been a downward trend for manufacturing in developed countries due to the outsourcing of these activities to low cost production areas such as South America, Eastern Europe, Asia and Mexico. Even countries like China, the “poster-child” for low-cost manufacture, have experienced increasing wage rates and decreases in output. As manufacturing centers continue to relocate to the next emerging markets, countries will increasingly turn to the services sector to support economic growth.

Domestically, the United States is a service economy and generates the largest services trade in the world (“Services”). In 2012, services sector business contributed to 79.7 percent of GDP and accounted for four out of five jobs (“United States”, 2014). These contributions to the economy are especially important in periods of recession recovery. By definition, the services sector is very broad, including businesses that range from private education to healthcare. As an
example, Figure 2-1 shows relative contributions to GDP by industry (manufacturing and services), for the United States in 2012.

**Figure 2-1: U.S. Contribution to GDP by Industry (2012)**

Even in short time span since the U.S. Department of Commerce’s release of this data, the services sector has continued to expand. According to the most recent Non-Manufacturing ISM Report On Business®, “economic activity in the non-manufacturing sector grew in January for the 48th consecutive month” in the United States. The Non-Manufacturing Index (NMI®) is a composite index based on business activity, new orders, employment and supplier deliveries as reported by purchasing and supply executives from diversified industries. For January, the composite NMI® was recorded at 54.0, with a reading above 50 percent indicating that the non-manufacturing sector is generally expanding. For the first half of 2014, the majority of non-manufacturing supply managers are anticipating increased revenues, prices, capacity and capital expenditures. This indicates continued growth and likely an NMI® reading above 50 percent for the foreseeable future (Cahill, 2014).

Globally, services sector spend and employment is expected to increase as well. According to a study conducted by Manpower, “global service sector jobs are expected to increase by at least 500 million between 2004 and 2015.” It is predicted that the majority of these
jobs will be created in the Americas, Europe and the Middle East (“Global Service Sector Jobs to Rise by 500m by 2015,” 2009). Furthermore, data sources such as the monthly Global Services Purchasing Managers Index (PMI) continue to support forecasts of steady growth. According to J.P. Morgan’s most recent Global Services PMI ™, global services business activity has “expanded for the sixteenth successive month in January.” Overall, firms are reporting demand growth, headcount increases and a positive outlook for 2014, especially in Ireland, the UK and Germany (J.P. Morgan Chase & Co., et.al., 2014). As the global economy continues to rebound from recessions and downturns, growth, especially in the services sector, can be expected.

Overall, service sector business is crucial to both the U.S. and global economies. Expectedly, the high level of services spend exists in business-to-business purchasing as well. In a 2002 study, “115 firms across a variety of sectors indicated that services is about 33 percent of the total purchasing spend for the firm” (Ellram, et al., 2004). With the services sector’s contribution to GDP increasing yearly, this number is likely higher today. Despite a past lack of focus on service supply chains, as spend and contribution to GDP increase, supply chain professionals must constantly search for ways to better manage this unique sector.

**Identifying a Supply Chain Model & Process for the Services Sector**

Although a multitude of defined models and processes exist for the manufacturing sector, little research has been conducted to outline a similar framework for service supply chains. Portions of these models such as SCOR, GSCF and Hewlett-Packard, can be applied to a service context and combined, but as a whole they are inadequate. Due to the lack of a specific framework, both purchasers and providers of services are left to their best guesses on how to manage these supply chains effectively.
Before choosing a model and process to fit this sector, a working definition for service supply chains must be identified. Although this is changing, most traditional definitions disregard services entirely and focus on the movement of materials. A common variation of this type of definition states “Supply chain management is the management of information, processes, goods and funds from the earliest supplier to the ultimate customer, including disposal” (Ellram, 2004). Although information, processes, funds and sometimes goods are components in many service supply chains, this definition fails to address the human labor aspect of a service product.

According to Ellram, Tate and Billington, the definition of a service supply chain should be modified as follows:

“Supply chain management is the management of information, processes, capacity, service performance and funds from the earliest supplier to the ultimate customer” (2004).

This edited definition better addresses some of the challenges that purchasing companies and service providers face on a daily basis, such as performance and capacity issues. With an applicable working definition, a supply chain model can now be fitted to the services sector.

The four previously mentioned structural differences (heterogeneity, perishability, inseparability and intangibility) between manufacturing and service supply chains must be integrated into this new model. In the majority of articles that address the adaptation of traditional models to a services context, researchers have used the Supply Chain Operations Reference (SCOR) model, endorsed and created by the Supply Chain Council as a starting point. According to supply-chain.org, this particular model was designed to illustrate business activities related to satisfying customer demand (2014). The SCOR model, below in Figure 2-2, is designed around five main processes: plan, source, make, deliver and return, but is centered around a manufacturing firm sourcing from suppliers and selling to customers. One of the primary shortcomings of this model is that three of these five processes, make, deliver and return, are
completely irrelevant to the services sector due to the fact that services cannot be ‘made’ or transported (Giannakis, 2011). Secondly, the SCOR model implies production occurring at the manufacturer’s level, which is not applicable to a services context due to the inseparability characteristic of service supply chains (Baltaciaglu, 2007).

**Figure 2-2: The SCOR Model**

![SCOR Model Diagram](http://www.supply-chain.org)

Although SCOR’s five business activities contribute a general framework for supply chain processes, past research has looked to the Global Supply Chain Forum (GSCF) model for a more specific set of activities. For manufacturing, these processes include customer relationship management, supplier relationship management, customer service management, demand management, order fulfillment, manufacturing flow management (sourcing, production and delivery), product development and returns management (Croxton, et.al., 2001). While this model has strengths in that it includes key stakeholders and emphasizes the importance of information flows, like the SCOR model, GSCF focuses on product flow and includes a return cycle (Ellram, et.al., 2004). For a complete illustration of the GSCF model, see Appendix B.

The last source that researchers including Ellram et.al., referenced when creating a services-specific model is the Hewlett-Packard Model, which focuses mainly on illustrating the physical flow of goods throughout the supply chain. With similar weaknesses as the other models,
one advantage of the HP model is that it addresses uncertainty and capacity flexibility (2007). After combining the strengths of the three models and taking into consideration the four differentiating characteristics of service supply chains, Ellram, et.al., identified six key functions and incorporated them into a service sector specific model, as depicted in Figure 2-3.

**Figure 2-3: Services Supply Chain Model**

A condensed summary of all three contributing models, including strengths and weaknesses is included in Appendix B. The overarching theme of this model is the continuous presence and importance of information flow in service supply chains. Some important applications of this process are identifying demand, information sharing, developing statements of work and scope definition. The first process mentioned is Capacity and Skills Management, which refers to the investments that service providers make in human capital, assets and in the organization as a whole. “Service providers can differentiate themselves based on the availability and quality of staff or lack thereof.” Like the manufacturing sector, demand management is necessary to match capacity with forecasted customer requirements. Customer Relationship Management and Supplier Relationship Management resonate across all sectors, and proper attention to these two
processes is extremely important. Continuous communication with all stakeholders about performance expectations, scopes of work and satisfaction are themes within these categories. Service Delivery focuses on ensuring that buyer’s expectations are met and that performance and contract compliance are constantly monitored. Lastly, cash flow ensures that payments based on performance are made on time. In summary, both the buyer and provider are key stakeholders throughout all six processes and have a large impact on the effectiveness of any service supply chain (Ellram, et.al., 2004).

The Purchasing Process for Services

Although some would argue that a definitional difference exists, the terms purchasing and procurement are used interchangeably in this research. In the past, most procurement activity was referred to as purchasing before it gained perceived importance as a business function. It was thought of as a transactional necessity, rather than a strategic differentiator. As expected, the lack of relevant academic material extends from service supply chains to services procurement. In fact, before 2003, out of 774 articles published by The Journal for Supply Chain Management published in the thirty-five previous years, less than ten were centered on the topic of services procurement (Carter, et.al., 2003). Throughout the history of this function, purchasing professionals have “steadily improved the stature of procurement in the business hierarchy” and increasing numbers of companies have realized the substantial cost savings that buying activities can contribute to profit margins (Cruz, et.al., 1996). As procurement continues its upward shift in importance, continued attention should be paid to outlined processes to ensure effective execution.

In terms of a purchasing process, the majority of academia utilizes the six-step model by Van Weele as the academic standard. In this model, the process begins by determining
specifications and defining the business necessity. In the next two steps, suppliers are selected and the associated contracts are created. During the contract lifetime, the buyer orders goods or services from the supplier, monitors and expedites these orders. The last outlined step of the model is evaluation of contract and supplier performance. See Figure 2-4 below for a complete illustration of this process.

**Figure 2-4:** Van Weele's Purchase Process

![Diagram of Van Weele's Purchase Process](image)

**Source:** Van Weele (2005)

Although the actual number of steps and nuances of the process vary across organizations, all six of the above activities must be executed in some capacity.

In terms of a comparison of goods and services procurement, several key differences exist. For manufactured goods, this process is typically formalized with specific designation of roles and responsibilities for each party at each individual step; thus far, this level of specificity has not extended to services procurement (Ellram, et.al., 2007). Additionally, due to the four aforementioned characteristics of services, some of these steps are more challenging or cumbersome for services than goods. For example, many issues arise in the Specify step, due to the intangibility of services. Careful alignment and clarification of expectations between supplier and buyer at this first step in the process helps to mitigate confusion and performance issues later in the process. Another challenge that can occur during the Contract and Order steps is that services are “more difficult to quantify in terms of costs and thus difficult to price.” Between goods and services procurement, differences can also occur in the amount of time, level of detail, outside stakeholder involvement and information sharing associated with each step of the process. (Van der Wel, et.al., 2009). It is important to recognize that the exchange process is very different...
for the two sectors. As mentioned previously in regards to the inseparability characteristic, the production and consumption of services is an interactive process between the buyer and seller, rather than two events separated by location and time. Buyers must assume a proactive role in the development, delivery, production and consumption of the service through ongoing interaction with the supplier. Acknowledgement of the inherent differences between goods and services procurement processes is crucial to an organization’s success.

**Purchasing Professionals’ Perceptions**

Several studies exist that address the gap in literature regarding industry professionals’ perception of differences between goods and services purchasing. In the first study, conducted by Smeltzer and Ogden of Arizona State University, qualitative interviews of fourteen purchasing executives and a quantitative survey of eighty-two purchasing managers were utilized to test perceived differences. One of the first realizations this specific research made was that purchasing professionals can easily differentiate the purchasing of goods versus services, but many purchases have both a material and service component; in other words, “A pure service or pure material seldom exists.” Their next conclusion was that purchasing managers perceive the service purchasing process as different and more complex than goods, and that this complexity is dependent the clarity of specifications and the involvement of a professional cross-functional team. Those surveyed also noted “material specifications are generally more complete than service statements of work. Figure 2-5 illustrates the data supporting these conclusions.
The third conclusion was that historically, more emphasis has been placed on material purchasing thus “more support is provided to ensure clear specifications, supplier certification and performance measurements.” Respondents noted that this added to the complexity of services purchasing. Also regarding the concept of “support,” the report concluded that “cost analysis and negotiation are much more difficult with services than with materials” due to a lack of historical emphasis on service cost analysis training and relevant total cost of ownership models. Lastly, those surveyed felt that top management “believes service purchases are less complex than material purchases” and “are much more inclined to bypass the purchasing organization when buying services than when buying materials.” In summary, this research affirmed that purchasing professionals do perceive differences between the two types of purchasing and that distinct approaches are necessary to manage them effectively (Smeltzer, et.al., 2002).

A second similar study analyzed questionnaires completed by seventy-one Dutch purchasing managers to uncover specific difficulties associated with buying services. Those surveyed submitted responses ranging from 1 (totally disagree) to 5 (totally agree) on twelve different statements related to buying services. The topics of these questions ranged from “Quotations from service suppliers can hardly be objectively compared” to “There is insufficient (scientific) knowledge available on buying services.” The resonating feedback from this study’s results is quoted directly below
1. It is more difficult to develop specifications for services than for goods.
2. Preparing for a detailed service level agreement usually takes more time and effort.
3. It is more difficult to evaluate the performance of services providers.
4. Most similarities with buying goods are found in selecting and contracting with suppliers.

In summary, these conclusions support the assumption that purchasing professionals, even on a global level, experience challenges associated with services procurement (Van der Valk, 2009).

In general, the findings from both of these studies align and achieve a mutual conclusion that specific challenges are inherent in the purchase of services and they must be addressed to improve procurement processes and end results. Understanding the field’s general perceptions of services procurement is important to this research because it is key to determining challenges, and ultimately, best practices.

**Current Challenges in Services Procurement**

Based on studies and academic research, several sources have identified typical challenges that occur in services supply management and their drivers. After compiling these common issues, they fall into two categories: organizational and procedural.

**Organizational Issues**

The underlying cause behind many issues found in services procurement is a continuous lack of recognition that a problem exists (Ellram, et.al., 2004). Despite the high magnitude of spend and impact on bottom lines, procurement professionals often receive little support from top management on improvement initiatives and similar efforts. Due to this lack of attention, services are still managed unprofessionally often by the end user without input from procurement professionals on proper methods to draft contracts, evaluate performance or ensure payment.

**Figure 2-6** illustrates the lack of formal procurement involvement in services outsourcing. Even
service categories with the highest portion of formal supply management such as travel barely reach the seventy-five percent threshold.

**Figure 2-6:** Formal Procurement Involvement in Outsourced Services (Ellram, et.al., 2007)

This fragmented and decentralized structure lends itself to a growing supply base. In many modern procurement organizations, it is not extraordinary for end-users to place orders with unapproved vendors for services; but it would be an anomaly for an unapproved purchase to occur in a materials context (Ellram, et.al., 2007). Due a lack of formalized controls and systems, the amount of service suppliers is growing at most organizations. Although supply base rationalization has been a longtime trend for goods, this has yet to catch on in services purchasing. According to Ellram, et.al., this movement towards a less manageable services supply base is a product of the decentralized nature of services spending (2007). It is important to note that poor management of the services supply base leads to profit consequences as well as risk implications.

Coupled with a lack of formalized service purchasing, those organizations that are managing service spend professionally rarely offer adequate support to their procurement functions. One common problem is a shortage of resources, human and financial, allocated to
services procurement. In the case of materials, companies such as Honda, Deere & Company and Intel employ detailed controls, cost engineers and financial departments to support their procurement counterparts with detailed cost structures and pricing models. This support creates cost savings year over year by helping to “facilitate improvement and fact-based negotiations.” Conversely, few resources are allocated to improve the procurement and management of services. One statistic that depicts this clearly is the number of suppliers (goods vs. services) assigned to purchasing managers. In a 2006 study, CAPS research data reported that a direct materials buyer, on average, manages thirty-six active suppliers while buyers responsible for services manage about 105. According to Ellram et.al., “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.” In addition to human resources, “services buyers are less likely to be supported by information systems than direct buyers” (2007). The overall lack of support to services procurement professionals hinders performance and cost management.

**Procedural Issues and Financial Implications**

As mentioned previously, one of the key challenges facing procurement professionals today is developing clear service specifications and translating them into contractual agreements. One of the primary reasons that specification development is so difficult is because companies are often outsourcing because they were not managing the service well to begin with. As Ellram, et.al., described, “If a company cannot manage and evaluate its own performance in a specific area well, how can it expect to manage the performance of a third party that provides that service?” (2004). Additionally, due to the service characteristic of heterogeneity, these specifications are often extremely vague, in order to accommodate the inherent variations in service execution. In terms of quality, it is subjective and user-dependent, which makes it difficult to define and measure. Unlike materials, where verification of contract completion is achieved through a physical shipment, services are controlled by an internal sign-off without tangible
evidence (Ellram, et.al., 2004). This system is missing the financial controls that exist in the materials context. Many of these issues are simply caused by the intrinsic qualities of a service product.

A symptom of poorly developed specifications is often value leakage in the services supply chain. Without aligned expectations, it’s impossible to “objectively determine whether a service provider is performing its job as agreed.” Correspondingly, without the proper controls, “significant opportunity exists for service providers to profit unfairly.” It is in the supplier’s best interest to withhold information, such as staff changes, discounts and cost structures, to gain larger profits. Without clearly defined contracts and service level agreements, “scope creep” is an inevitable consequence. It is logical that suppliers would be glad to continuously find more problems, extend project timelines and ultimately increase revenues (Ellram, et.al 2004).

Lack of visibility and control into a supplier’s inner-workings is a constant problem in services procurement. Currently, suppliers are outwardly resistant to reveal their actual costs. This leads to “limited, win-lose negotiations” and makes it challenging to determine price fairness (Ellram, et.al., 2007). Although services procurement managers should develop commercial models that mitigate opportunistic behavior and enforce them through agreements, there currently is a shortage of expertise on how to implement this type of structure effectively. Another typical financial implication is over-billing by suppliers. Based on actual data, Ellram, et.al., concluded that firms typically lose up to five percent of total profit due to a lack of visibility into billing of services beyond what was originally contracted. This has significant implications on the bottom line for any organization involved in services procurement (2007).

Understanding these current challenges is crucial to this research and eventually the development of best practices for this function. These challenges and the current state of services procurement will provide a context for interviews and discussion of findings.
Chapter 3
Methodology

This research has been focused primarily on large, multinational companies and is qualitative in nature. Purchasing professionals from seven different companies were contacted based on a convenience sample to be interviewed about their experiences in services procurement. Due to the niche nature of the sector and lack of formalization of service purchasing, it was challenging to find respondents that fit the ideal profile (purchasing managers whose key responsibilities included managing services of any type). Out of those contacted, six responded and were interviewed. The interview guide included questions regarding their current role, supplier selection processes, contractual agreements, supplier relationship management, performance management and their perception of challenges within services procurement. Although the interviews were informal, the same questions were asked to all interviewees to ensure consistency of responses. See Appendix C for complete interview guide.

Of the six companies interviewed, five companies were large, well-known, international corporations. Four of these five companies are a part of the Fortune 500 Global Top Companies and all five are included in the domestic Fortune 500. The sixth company was smaller in revenues than the others, but still boasted a prominent service purchasing presence. Revenues for these organizations in 2012 ranged from 4 to 452 billion U.S. dollars with a combined average of 158 billion. Total number of employees ranges from 3,185 to 466,995. Four of the five companies fall between 58,000 and 88,000 with two upper and lower outliers (“Global 500 Full List,” 2013). For confidentiality reasons, the names of these companies and purchasing professionals will not be disclosed.
These companies vary by industry, ranging from energy to personal care, and three of the five organizations have international headquarters in countries outside of the U.S. In terms of types of procured services, these vary widely including engineering services, capital equipment maintenance and warehousing solutions. Roles of those interviewed vary in scope and level, including category leads and indirect procurement directors. Additionally, all six respondents reported that their respective procurement organizations were in different stages of development, often noting recent reorganizations and structural changes.

The interview answers, coupled with several supporting documents and files provided by those interviewed, were consolidated, analyzed and compared to discover trends and similarities within services procurement processes. Despite the large variation in industries, purchased services and stage of procurement organization development, many similarities were discovered in respect to operations across the six companies. By combining each respondent’s commentary on company methods and respective perceptions of their success, best practices in services procurement were identified.
Chapter 4

Discussion of Findings

After compiling the notes and responses obtained through the interview process, both similarities and differences existed between the six purchasing professionals’ experiences in services procurement. By separating each interviewee’s practices into categories and standard activities involved in procurement, better comparisons can be made. A combination of the interview guide (Appendix C) and the most common activities performed in typical procurement organizations were used to determine the following separate categories. Several of these activities correlate directly with Van Weele’s Purchase progress in Figure 2-4.

1. Category Composition & Supplier Selection
2. Contractual Agreements
3. Performance Management
4. Supplier Relationship Management
5. Perceptions & Challenges

Category Composition & Supplier Selection

Before evaluating each procurement organization’s unique processes, it was necessary to understand the composition of the category at hand, including how many suppliers the procurement professional managed, what types of services were purchased and the relative importance of this services spend to top management. In this research, all procurement organizations utilized the “category management” approach where similar services and suppliers
are grouped together and assigned to a team or employee to manage. This facilitates growth of expertise in a specific purchasing realm and enhances benchmarking abilities.

In terms of number of suppliers, the responses varied greatly across the six interviews. While two of the procurement organizations were very mature, moving towards single-source situations within their categories, two organizations reported over 500 secondary suppliers within their category. Both of these respondents noted that despite the large total number of suppliers, around fifty suppliers contributed to about eighty percent of total category spend. Especially in the case of professional services, where self-employed contractors are frequently hired for specific expertise, the raw number of suppliers can be misleading. Additionally, one procurement professional explained that in certain industries, including financial services, the formalization process from tactical purchasing to strategic procurement was just beginning to gain importance in the eyes of leadership. Due to previously high levels of profitability and antiquated mindsets, purchasing organizations were seen as non-value adding functions that only contributed bureaucratic inefficiency. On the other end of the spectrum, in developed procurement organizations transitioning to sole-source situations, these particular respondents developed a high level of trust in their suppliers’ ability to accommodate capacity changes and deliver a quality service consistently. One visible trend was that more mature purchasing organizations had fewer suppliers within a category, ranging from one to ten, while companies that were just beginning to optimize and improve reported significantly more. Although individual suppliers may provide a unique service, it is important to note that both supplier management costs and risk increase correspondingly with the size of a supply base. By assigning procurement professionals to an excessive number of suppliers, it is nearly impossible to commit the required degree of attention to the category.

The basics of supplier selection seem to be the most agreed upon purchasing activity among the six interviewed professionals. All reported similar procedures of utilizing the Request
for Information (RFI) and Request for Proposal (RFP) processes to obtain supplier information and pricing. Additionally, several interviewees noted that RFPs were sometimes utilized to gauge and benchmark market pricing, even when onboarding a new supplier was not the intended result. Another respondent explained that when initiating a consulting project, RFPs were utilized to select a specific supplier for the work. He or she also noted that these RFPs were extremely beneficial, as they essentially solicited free potential solutions to the problem at hand and could be utilized later on, even if that particular supplier was not selected. In most cases, interviewees mentioned that RFI responses were used to create a short list of potential suppliers to whom RFPs were sent. When asked what factors were most important to the category (quality, cost or delivery) most interviewees reported a combination of quality and cost, with a greater emphasis on quality of service. Three respondents explained that cost sometimes was not even a determining factor, due to relatively equal prices among potential suppliers. This usually occurs in general, non-technical services where competitiveness is determined primarily by price. In the other respondent’s cases, initial pricing was an important input, but quality always took precedence because poorly performed services can result in even greater end costs. Several interviewed companies are involved in heavily regulated industries where stringent quality and safety standards are enforced. These procurement professionals placed a special emphasis on quality over cost due to the dire impact a lapse in service delivery could have on operations.

When asked which additional stakeholders and functional groups were involved in the supplier selection process, the interviewees listed a wide range of responses. The most frequented stakeholders are listed below

- End-User (service requestor)
- Engineering
- Finance
- Legal
Four of the six interviewed reported the use of a cross-functional committee to select suppliers. This team of individuals included both subject matter experts and procurement staff. Two of the interviewees explained that the next step in the selection process was making recommendations to a review board, composed of vice-presidents or leaders of the above stakeholder groups. This step in the process was led by the category manager or commodity director, and served as a gatekeeping step in the supplier selection process. This type of gate-keeping procedure is a common feature of developed, risk-averse procurement organizations. Although it can be beneficial in reducing financial risk and ensuring stakeholder agreement, too many gate keeping steps can hinder the efficiency of procurement operations, lengthening and complicating the process.

One difference among the interviews was the frequency and nature of the supplier selection process. While the mature procurement organizations rarely added new suppliers, due to the costliness and time-intensity involved, enlisting new suppliers was a frequent procedure in several interviewed companies. In the developed procurement organizations, there seemed to be a greater emphasis on long-term strategy and extended relationships with preferred suppliers. Conversely, one interviewee explained that the suppliers within his or her category were primarily determined by end-users and added upon receipt of their requests. Although most types of services are better suited for supplier optimization and long-term relationships, some services are niche in nature, requiring frequent updating to the supplier base. Additionally, geographical factors can affect both number of suppliers and frequency of selection. If a service provider is needed in a remote area, where few competitors or current suppliers exist, procurement professionals are somewhat limited in options. On the other hand, if a priority supplier has a global presence and the capacity to complete all required services, supplier selection may be unnecessary and/or infrequent.
Contractual Agreements

Contractual agreements, in terms of structure and organization, differed widely across the six interviewees. Furthermore, many mentioned that contract structure could vary even across suppliers within their category, depending on supplier priority and spend level. A common trend among the companies interviewed was that suppliers with higher business importance usually required lengthier and more detailed agreements. Other elements of contract structure such as included sections and payment schemes differed mainly by type of service.

In terms of contract length and time between renewals, all companies noted a recent push for longer contract terms and less frequent renewals. The lifetimes of contracts ranged from three to twenty years and several respondents reported that procurement leadership enforced contract length minimums that must enter an approval process to be bypassed. This is primarily due to the extensive cost and time commitment that are required in contract drafting, negotiations and implementation. One respondent explained that in his or her category of six global suppliers, they were currently involved in three-year contracts and shifting towards ten-year agreements. This category’s largest issue was the yearly rate renewal process. For each of the six suppliers, the contract included two to fifteen price sheets for each global location. Due to the extensive work involved in communicating and approving changes with these suppliers, this procurement professional noted that renewals often were not finalized until eight months into the next year. In other situations, this type of renewal process did not exist. In two of the other cases, contracts involved servitization of equipment, and this service was purchased at a fixed price (in some cases with an initially agreed-upon discount structure) throughout the length of the contract. Although proposed changes and negotiations were welcomed at any time, this process was completed efficiently.
Payment and reimbursement models within the described service agreements varied the most across the six companies. While some parties agreed to set levels of spend, others utilized open-ended contracts with no spend commitment, often referred to as “reimbursable contracts.”

In the least cost-controlling case, which was mentioned above, the procurement professional had to manage rate sheets for each global location of six suppliers. These pricing sheets were estimated ranges (low, high and average) of base rates for twenty to fifty commonly requested service roles. When work orders were received from end-users, additional costs were applied to the base rate, by either a percentage or additional currency per hour, including but not limited to the supplier’s office overhead, corporate overhead and burdens and benefits. This company then paid the supplier the calculated end-rate. These percentages and additional currency per hour were standardized, included in the contract and re-evaluated yearly. Although in theory this is a logical commercial model, it was extremely challenging for this company to verify the supplier’s costs and evaluate the accuracy of invoices. During each renewal, the company would request a cost breakdown and “evidence” of these additional costs, but many suppliers were reluctant to oblige and only sent limited information. This type of commercial model requires a deep level of trust, and ultimately does not factor performance into pricing; these suppliers were incentivized to perform rework and extend project deadlines.

In a similar, but more effective case, a company utilized a catalog of commonly used service roles across all suppliers with “do-not-exceed rates.” All suppliers could determine hourly rates at their discretion, but they were not permitted to surpass the do-not-exceed rates unless initially agreed upon exceptions occurred. This procurement professional explained that, ultimately, they do not care about the supplier’s costs as long as the charged price falls under the maximum. Charges above the do-not-exceed rate were even measured monthly as a KPI and suppliers that frequently charged above the maximum were penalized with fees or decreased business. This strategy eliminated the majority of the verification work involved in the previous
case, but showed a different power split between buyer and supplier. Without the majority of the power in the buyer’s hands, this type of pricing model would not be possible.

In the two cases involving purchase of equipment servitisation, purchasing organizations utilized a fixed-fee cost model with their suppliers. Rather than paying technicians hourly to perform equipment maintenance or repair, these companies paid their suppliers a yearly fee, paid monthly, to complete all required work. This included preventative maintenance, repair, parts and replacement, if necessary. The benefit of this structure is that suppliers are incentivized to keep equipment operating. For example, if the equipment is well designed and incurs no breakdowns, the supplier can keep the yearly fee entirely as profit, minus the cost of preventative maintenance. Additionally the purchasing company avoids the cost and time associated with administrative tasks such as scheduling and transactional payments. One of these two companies reported that when they previously paid suppliers hourly to service equipment, mean time between failures or repairs was between thirty to forty months. Upon implementation of this fixed-fee model, this metric increased to over one hundred months. This metric is an important measure to this company and is monitored frequently. When suppliers are incentivized by profits to deliver a quality product and service, performance metrics like this are bound to increase and this benefits both the buyer and supplier.

Another respondent also utilized do-not-exceed rates, in combination with a fixed fee model. Lists of potential roles (i.e. partner, senior consultant, consultant) had maximum rates listed in the master services agreement, but for each project, a fixed fee was implemented based on the estimated necessary manpower and project timeline. This model is highly cost-conscious because it shifts the majority of the financial risk to the supplier and encourages them to complete deliverables efficiently. Additionally, this company negotiated discounts for high spend engagements and “fees-at-risk” clauses into their contractual agreements. If poor performance or failure to complete deliverables was evident through measurable outcomes, through the fees-at-
risk clause the buyer could take back a percentage of all fees paid, ranging from ten to one hundred percent. This procurement professional explained that especially in the case of consulting and other professional services, it is important to creatively structure payment schemes to align incentives. These contractual agreements also limited expenses (travel, per diem, etc.) to a specified percentage and compensated consultants at a day instead of hourly rate to avoid non-efficient overtime hours. In this case, it was clear that a deep level of trust existed between the two parties and that the buyer had earned respect and leverage in the relationship.

In another case, a company previously performed warehousing and kitting services internally, but recently outsourced these services to one provider. This supplier was paid a percentage of the value of goods that they managed; for example, if the supplier warehoused one million dollars of goods, they would automatically receive a set percentage (i.e. two percent would be $20,000). Although this payment method does not necessarily incentivize service quality, it encourages increased capacity, which was more important to this particular buyer. To further this goal, the contract included a minimum level of business, which the purchasing company had to meet or pay a fee. Additionally, once the company reached higher volume tiers, rebates and discounts were credited to the purchasing organization. By designing payment structures that align with internal goals, such as quality or capacity, purchasing organizations can incentivize their suppliers to perform accordingly.

In addition to the payment section, these contracts included a variety of other sections and amendments. A common theme among all respondents was that they noted the importance of including every possible requirement or issue initially in the contract in order to avoid difficult negotiations in the execution phase. The most common sections or components described by respondents, in addition to payment, are listed below.

- Legal Terms & Conditions (Dispute resolution, proceedings etc.)
- Purchasing Company Code of Conduct/Ethical Requirements
The content of a service level agreement is extremely important to the success of the purchasing relationship. It encourages service quality and helps both parties to plan for the future. Additionally, sections that detail information on ethics and similar processes ensure that buyer and supplier can align company cultures accordingly. All respondents alluded to the fact that the most successful contractual agreements account for all possible scenarios to avoid future conflict.

The last component of a service level agreement is utilized during implementation and application of the contract. When requestors submit work orders to procurement for a specific service, this request includes a statement of work detailing the required service. All respondents agreed that these statements must be as detailed as possible, especially when the service is extremely technical. Accordingly, respondents reported that these descriptions are usually written by the end-user due to their expertise on the service. The majority of the six companies interviewed all mentioned the challenges involved in encouraging end-users to write complete and comprehensive statements of work. As the middleman between end-user and supplier, purchasing organizations must verify the thoroughness of statements of work in order to ensure service delivery quality.

Due to lack of ability to store service inventory, most companies reported that demand forecasting is a challenge, but not a key focus area. If forecasts are available, respondents explained that they are general estimates and vary widely from actual data. One respondent noted that although a purchasing organization may be able to forecast total services spend for a year, it
is near impossible to specify or categorize this spend to a specific type of service or supplier. Most companies stated that their suppliers had little difficulty maintaining adequate capacity to accommodate their business, and that this was rarely an issue. One respondent, with many suppliers in his or her category, said that this problem only arose with small niche suppliers on an infrequent basis. Nevertheless, as overall demand for services increases due to globalization and other factors, procurement organizations must constantly monitor supplier capacity and augment supply bases as needed.

Performance Management

As mentioned previously, performance management is a key responsibility of purchasing organizations and is critical to operational efficiency. In the case of services, quality is subjective and sometimes very difficult to measure. Nevertheless, procurement professionals and key stakeholders must identify quantifiable metrics to evaluate supplier performance. These metrics should align with internal goals and affect supplier profit.

Across the six respondents, five reported that they collected or measured KPIs, a scorecard or heat map on a monthly basis. The sixth interviewee explained that metrics were collected and developed for each specific service engagement, and that these measures had yet to be standardized across his or her category. The key differences between the five reporting procedures arose in type of metrics, which party held responsibility for collecting the metrics and issue resolution procedures. In terms of types of metrics, respondents mentioned the following categories and examples

- Cost (i.e. adherence to do-not-exceed rates)
- Quality (i.e. mean time between failures)
- Innovation (i.e. number of continuous improvement initiatives)
• Safety (i.e. OSHA metrics)
• Contract Adherence (i.e. adherence to payment terms)
• Communication Efficiency (i.e. time to respond to request)
• Capacity (i.e. capacity and positions unfilled)

Although the individual measures varied widely, all were similar in that they measured suppliers’ achievement of key contract and business goals. All respondents collected metrics consistently and maintained historical data in order to identify trends and patterns. Additionally, the majority of companies reported that establishing acceptable thresholds was necessary to determine what a “good” metric looks like. Another observation made by an interviewee was that all measured KPIs must provide an explicit benefit to performance management. If stakeholders do not understand the purpose of a metric, its collection typically results in wasted time and money.

Several organizations reported a current effort towards improvement and optimization of supplier KPIs, often mentioning a reduction of metrics. Simplification of practices such as metric collection is a current trend in many purchasing organizations.

Another difference in performance management arose in which party held responsibility for collecting and reporting metrics. Four companies reported that this task was completed by the supplier, one company reported that project end-users submitted metrics and another outsourced this process. In the third case, KPI collection was completed entirely by a “managed service provider” (MSP). The outsourcing of the administrative tasks (such as metrics) involved in services procurement to MSPs is another current industry trend. This MSP also organized supplier relationship meetings, collected end-user requests and statements of work. Although the MSP compiled and communicated KPIs to the purchasing organization, the company still held internal control over strategic decision-making and performance improvement initiatives.

Upon realization of an issue or poor supplier performance, the six companies undertook varied actions. The respondents explained that typically, issues are presented by end-users and
escalated through procurement until resolution. Furthermore, most reported a buffer period of one month to a fiscal quarter allowed for suppliers to proactively correct issues before buyer intervention. At this point, several respondents reported the initiation of a formal issue resolution process, implemented through either a performance improvement plan (PIP) or financial penalties. Accordingly, communication between buyer and supplier increased during this period until the supplier improved performance. One respondent explained that he or she always makes positive assumptions about issues initially and presumes good intentions on the supplier’s part until contradicting evidence is verified. He or she noted that this type of trusting behavior is crucial to maintaining long-term relationships with key providers. If an issue continuously remained unresolved, most respondents reported that a strategic conversation around maintaining or eliminating the supplier would begin. This typically only occurred in the case of small suppliers, and large issues rarely arose in global, long-term relationships.

Supplier Relationship Management

Along with performance management, procurement organizations must manage supplier relationships consistently to foster effective communication and trust. Even when no issues arise, constant interaction with suppliers is critical to these goals. Of the six companies interviewed, all proactively participated in supply relationship management in differing capacities.

All respondents reported regularly scheduled relationship engagements complemented by phone calls, e-mails and meetings as needed. In most cases, the procurement professionals served as the key contact to the supplier. Many noted that concerns or talking points were often escalated through procurement from end-users, project managers or other stakeholders and communicated to the supplier. Four of the companies interviewed mentioned formal in-person meetings either quarterly or annually with their category’s most strategic suppliers. These engagements usually
targeted key issues or highlights from the period and involved various functional leadership including vice presidents of procurement, engineering and business units as well as key personnel from the supplier’s end. Although these meetings served a practical purpose, participation from leadership also signaled recognition and appreciation of each party’s business. In one case, a respondent noted that these meetings could include many stakeholders across their entire business due to a supplier’s breadth of business importance. He or she noted that large companies, such as General Electric, may provide goods and services to many areas of the business, and that these collaborative meetings helped the company present “one face” to the supplier and visa versa.

Beyond simply maintaining frequent communication via e-mails and meetings, all of the respondents noted the importance of gaining trust with suppliers by approaching relationships effectively. In an ideal relationship, both parties provided a mutual benefit and recognized the importance of each group’s business. Openness, business etiquette and signs of respect were noted as key factors in fostering this type of relationship. Whether this occurs through providing requested information in a timely manner or awarding additional business to a valued supplier, both parties can help in continuously improving a partnership.

Perceptions & Challenges

After interviewing the six procurement professionals on their companies’ specific purchasing practices, several questions relating to their perception of challenges were presented. Although each response varied by level of experience, past roles and general opinions, many findings aligned directly with aforementioned conclusions from other research.

When asked whether or not a difference existed between materials and services procurement, two respondents believed that the general processes were relatively similar and only differed in minute ways. These two respondents also disagreed that services procurement was
more complex than materials purchasing. One respondent explained that although the purchased product can differ significantly, “good” procurement, of any type, is solely dependent on knowing your business well, being a good businessperson and developing unique ways to structure agreements with suppliers. In the other four cases, professionals believed that procurement of services versus goods required a different approach and/or was more complex. One respondent explained that the complexity of services derived primarily from the involvement of people. He or she continued, stating that while specification questions about goods such as size, shape or color solicited definite answers, services were not as clear-cut or black and white. Another respondent noted that services procurement was challenging because both parties must spend time initially aligning expectations due to the subjectivity of perceptions and quality. This procurement professional also noted that senior leadership does not value services spend as much as goods. Several interviewees agreed and explained that many end-users or other stakeholders believe that they can purchase services better than designated procurement staff and that it is a somewhat unnecessary function.

When asked about the biggest challenge in services procurement, three respondents stressed the difficulty in obtaining transparency from suppliers. A lack of openness towards cost breakdowns and future engagements with competitors were mentioned. One interviewee explained that this is primarily due to suppliers’ instinct to protect their respective profit margin. Although this is an understandable impulse, buyers must work with suppliers to develop sufficient trust to facilitate information sharing. Additionally, this information sharing must go both ways; purchasing organizations should proactively identify ways to reciprocate this benefit. Another challenge, mentioned by three interviewees, was related to the triangular relationship between service requestor, procurement and the supplier. Two professionals stated that end-users often want to request specific suppliers or contractors and bypass procurement entirely. Additionally, one of the interviewees explained that procurement professionals must “gain their
seat at the table” and prove their expertise through demonstrated knowledge and success. Another respondent mentioned that executive end-users from different purchasing companies often discuss pricing during social engagements and then proceed to present discrepancies, sometimes aggressively, to procurement. Other frequently mentioned challenges in services procurement included teaching small suppliers proper business practices, writing well-defined statements of work with measurable deliverables and developing adequate market expertise. Although all of the respondents mentioned initiatives to counteract these challenges, progress was reported to be relatively slow and only possible with the support of procurement senior leadership.
Chapter 5

Conclusions and Recommendations

Based on the knowledge gained through the interviews of these six procurement professionals, certain practices and approaches have proven more effective. Additionally, several improvement strategies were identified and mentioned by the interviewees. The compilation of these best practices categorized and detailed below.

Category Composition & Supplier Selection

In terms of category composition and number of suppliers, this depends primarily on the nature of the purchased service and number of staff assigned to the management of these suppliers. While some categories may contract with only five core suppliers to accommodate their service and capacity requirements, an evolving field such as subsea engineering might require many small suppliers that offer unique competencies and niche services. In any case, purchasing organizations should ensure that they maintain adequate staff to effectively manage the size of the supply base. At most companies, a strategic reduction and optimization of their services supplier base is necessary and would be beneficial in reducing risk and the administrative costs associated with supplier management. Additionally, procurement professionals are able to establish better and long-lasting relationships with the remaining priority suppliers. Although this has been a common practice in materials procurement for the last twenty years, a 2006 study reported that fifty-eight percent of companies indicated an increase and only four percent reported a decrease in the number of services suppliers (Ellram, et al., 2007). Companies should initiate optimization within their service supply base in order to achieve the proven benefits of reduced cost and risk.
When selecting suppliers, many practices utilized in materials procurement can be directly applied to services. Most companies practice this and all of the interviewees mentioned the use of RFI and RFP processes gain information on the supply base as a whole, create short lists and then select suppliers based on the received proposals. While materials suppliers are typically selected objectively based on cost, it can be more challenging in the services context to evaluate a potential supplier’s competencies and the quality of their staff. Without past experience with a supplier, procurement organizations must conduct intensive market research or gain knowledge through “word of mouth” about a service provider’s quality. Another critical difficulty in the evaluation of supplier proposals is understanding the proposal’s total cost of ownership. While materials costs are typically more straightforward, service rates are often coupled with hidden cost drivers, such as insurance, travel and lodging expenses that can result in dramatically different billing rates. Procurement organizations must allocate sufficient resources and time to the competitive process for service purchasing to account for these complexities. Additionally, companies should conduct in-depth research and analysis into proposals in order to supplement the evaluation process with quantitative information, rather than qualitative, whenever possible. Due to the subjective nature of services, this can be a challenging but financially rewarding addition to the supplier selection process.

**Contractual Agreements & Specifications**

In terms of specific content included in service-level agreements, this will vary by company, supplier, nature and length of the contractual relationship. In this research, all interviewees agreed on common components that should exist in all SLAs including terms and conditions, payment terms and performance measures. The resonating trend among all interviewees was an emphasis on including all expectations and accounting for all possible scenarios, good or bad, in the initial contract. This prevents procurement professionals from having to initiate difficult conversations and negotiations with suppliers later in the contract life.
Furthermore, SLAs should always include provisions that allow the purchasing company to audit the supplier for quality and transaction history at any point in time. This is one of many business controls that can be implemented in procurement organizations along with stringent approval processes and cost monitoring. Although a general scope of work is often included in the SLA, the most challenging part of executing this kind of contract is developing clear specifications to be included in each work order or contract transaction.

Although many disregard the importance of well-defined specifications, they are the primary contributor to the success of a service purchase. The first step in developing effective specifications is identifying relevant stakeholders (internal and external) and determining how they are involved in the delivery of the service. Then, each individual’s objectives can be identified. The most important component in creating these objectives is to be extremely specific and to utilize quantifiable measures of deliverables whenever possible. This type of measure can be easily converted into KPIs, which simplifies performance management and eliminates the difficulty in determining service quality. When vague specifications are used, the uncertainty allows suppliers to advance self-interest and profits by billing more hours. Detailed specifications are the first step in preventing this behavior. Typically, procurement and the end-user should develop the initial specification and then obtain input from the supplier to further detail the specification. When the supplier, buyer and end-user collaborate and are clear on expectations upfront, fewer issues and misunderstandings arise later on. Additionally, by utilizing quantifiable deliverables and metrics to measure the success or completion of the service delivery, it is easier for companies to transition to performance-based contracts. In this type of contract, suppliers are rewarded in some manner for exceeding expectations and penalized for poor performance.

Although performance-based contracts provide a great benefit to the purchaser by eliminating the financial risk of paying for an unsuccessful service, this structure is only possible when performance can be measured quantifiably and proven with data. Most suppliers are
unwilling to accept a financial penalty simply based on the purchasing company’s qualitative perception of their performance. This type of contract is one of the ways procurement organizations can creatively structure agreements to align incentives between buyer and supplier. Without this alignment, there are many opportunities for suppliers to profit unfairly. Beyond just performance-based contracts, other measures must be taken to reduce costs to purchasing organizations. As mentioned previously, some interviewed companies utilized do-not-exceed rates or paid suppliers through a fixed fee model, which both limit final costs. Although the do-not-exceed rate structure requires extensive market research, the buyer can reap significant financial benefits in the long run. The fixed fee model is another format of a performance-based contract, as the supplier benefits by completing the service effectively and quickly but can lose profits through inefficient service delivery. In addition to the contractual payment scheme, procurement professionals must carefully manage initial rates, renewal increases and then verify through market research. When buyers have limited information or are unknowledgeable on market pricing, supplier sales forces can withhold discounts or benefits, which ultimately raises costs for the buyer. With extensive research and market intelligence, procurement professionals can gain negotiating power and control these costs.

Even after the payment structure and rates are agreed upon, there are additional ways that services suppliers can cause procurement organizations to pay more than initially expected. As mentioned previously, hidden costs such as excessive travel expenses can add up throughout a contract lifetime. This can be avoided through maximums, other provisions and penalties written into the SLA to discourage this behavior. Secondly, billing and calculation errors occur much more frequently in services purchasing than in materials. It is not uncommon for work orders and invoices to include incorrect rates and bundled charges. Thirdly, several interviewees reported that they experienced issues with suppliers substituting lower-skilled staff. This is especially challenging due to subjectivity involved in determining the quality of a human service. Although
other opportunities to profit unfairly do exist, these three events represent the main contributors to unfair profiting by suppliers. According to Ellram, et.al., “hundreds of in-depth audits of services procurement relationships in a number of large companies suggest that the typical Fortune 500 company is “overcharged” nearly five percent of contract value for the services it procures” (2004). The primary method to combat this discrepancy is through continuous monitoring of invoices and then an audit of supplier transactions, if necessary. Also through the development of long-term, trusting relationships it is less likely that suppliers will purposefully take advantage of their customers.

**Supplier Relationship & Performance Management**

Supplier relationship management and performance management are coinciding tasks in the majority of procurement organizations. While performance should be measured on a constant basis through scorecards, KPIs or other metrics, these are typically reviewed and discussed in supplier relationship meetings or phone calls.

In terms of performance management, all of the interviewees undertook similar steps to monitor SLA compliance and service delivery. Although the categorization and specific metrics varied by company, all respondents stressed the importance of quantifiable metrics with established thresholds to determine what constitutes “unacceptable,” “acceptable” and “exceeding expectations” for each measure. Additionally, companies should take caution in collecting and measuring too many metrics, as this often creates further administrative work with little additional benefit. Procurement organizations should also develop standardized processes for addressing poor performance as indicated through metrics. This can be accomplished in many ways, but typically occurs through an initial discussion with the supplier and is then escalated through performance improvement plans or more drastic measures such as a temporary suspension of business. In addition to performance management, procurement professionals are also responsible for establishing and managing lasting relationships with service providers.
Methods and processes for supplier relationship management vary widely and are determined primarily by the importance (financial and operational) of the business relationship. Procurement organizations should develop defined processes to prioritize service suppliers in terms of importance. One common practice is to utilize a Kraljic matrix, where suppliers are categorized by supply risk and purchase importance into the four quadrants of strategic, leveraged, bottleneck and routine suppliers. See Appendix D for an illustration of the Kraljic model with examples of commonly purchased services. Although the actual execution of this process involves a degree of personal and leadership subjectivity, procurement professionals should generally allocate most of their time to strategic partners and less to routine suppliers. Ideally, the purchase and management of routine services can be accomplished solely through IT systems with little or no procurement intervention. After prioritizing suppliers, purchasing professionals should establish relationship management terms with suppliers including frequency and preferred methods of contact. With strategic suppliers, this typically includes day-to-day e-mail contact, monthly calls or meetings and a formal yearly engagement with senior level involvement. Procurement professionals must practice effective time management in order to resolve issues, provide performance feedback and communicate forecasted demand and upcoming projects to all of their delegated suppliers. In addition to ensuring frequent communication, procurement organizations should strive to create a mutual sense of trust and respect with strategic suppliers. Although this can be challenging during intense negotiations and conflicts, proper business etiquette and motions of good faith can mend temporary tensions. By building long-term and trusting relationships, purchasing companies can feel confident in the reliability of their suppliers.

**General Conclusions**

In many cases, organizations and academia alike have yet to realize the magnitude and importance of spend attributed to services purchasing. Due to the high financial impact, there are
infinite opportunities to decrease costs through even small efficiency improvements. This begins by allocating enough resources to service categories. Due to the late and ongoing formalization of services purchasing, procurement organizations today tend to allocate the majority of their human resources to materials categories. To resolve this imbalance, companies should commence the same strategic efforts and supplier optimization initiatives that were completed years before in materials categories. Organizations as a whole must quickly adjust to mitigate these issues by employing sufficient human capital, IT systems and processes to support the magnitude and potential risk associated with services spend.

To address the people component of this equation, companies should focus on augmenting their services purchasing staff. Whether this is through reassigning the company’s most skilled materials buyers to services purchasing, through new hires or through temporary hiring of an experienced consultant team, these additional resources will be the leaders in formalizing a company’s services spend. Experienced purchasing professionals will ideally be better equipped to negotiate contracts efficiently, manage risk, reduce costs, identify and select suppliers. In addition to skilled services purchasing staff, these professionals will need ample support from secondary functions such as finance, legal, market intelligence, project management and IT. Companies should take caution in augmenting procurement organizations without supplementing the supporting functions concurrently. Although a reorganization or improvement team will carry some initial investment cost, formalization efforts in services purchasing typically result in a substantial return on investment.

Similarly, academia has given little attention to services procurement and its research. As mentioned previously, very few relevant studies, articles and cases exist in this complex field. With the offshoring trend maintaining speed in the U.S. and other countries, this gap in knowledge should be prioritized and addressed quickly. While numerous topics of research have yet to be examined, a more important issue lies in universities’ and curriculums’ failure to
educate future practitioners on service supply chains and procurement. Textbooks often allocate a single chapter to services without relating the topic to processes and skill sets learned earlier. Furthermore, professors have been known to omit coverage of that chapter or section in order to focus on other subject matter deemed to be more important. Universities and their research arms must collaborate to address this gap, which will also help in accelerating the professionalization of services procurement. Through continuous and deliberate efforts by both academia and practicing procurement organizations, formal management of services spend will help companies to preserve a competitive advantage in the ever-changing global economy.
## Appendix A

Characteristics of Goods vs. Services that Add Complexity to Services Purchasing

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


Source: Ellram et.al., 2007
Appendix B
Supply Chain Models and Comparison

GCGF Model

Hewlett-Packard Model

HEWLETT-PACKARD MODEL

Lee and Billington (1995)
### Comparison of HP, SCOR and GSCF Models

<table>
<thead>
<tr>
<th>Concept</th>
<th>Focus</th>
<th>Support for Services SC</th>
<th>Weakness for Services SC</th>
</tr>
</thead>
</table>
| **HP Model** | • Suppliers, factories and customers are linked in the flow of goods, information and money, in an uncertain environment.  
• Multiple inventory stocking locations and possibly “safety” capacity provide the buffer for that uncertainty.  
• Focus on depicting the physical flow of goods among members of the supply chain.  
• Focus on recognizing and managing uncertainty  
• Uncertainty is represented by statistical variances. | • Considers buffers against uncertainty  
• Utilize capacity levels and flexibility versus inventory.  
• Allows consideration of trade-off in capacity level of the service provider and wait and service times for the customer. | • Services cannot be inventoried.  
• Cannot easily address the differences in quality of services. |
| **SCOR Model** | • Tools for charting supply processes and activities.  
• Utilizes a business process reference model that links process description and definition with metrics, best practice and technology  
• Organized around five primary management processes of plan, source, make, deliver and return. | • Focus on processes that link the supply chain.  
• Focus on depicting the physical flow of goods among members of the supply chain. | • Services are process driven.  
• The separate processes of make, deliver and return do not fit services.  
• Services do not have a return cycle. |
| **GSCF Model** | • Conceptualizes a supply chain that includes three elements: the business processes, the management components and the structure of the chain.  
• Product and processes flow through the chain, with consideration given to the return process flow as well.  
• Focus on processes that link the supply chain.  
• Focus on depicting the physical flow of goods among all members of the supply chain from supplier’s supplier to final customer. | • Participants from the beginning to end of the chain are included encompassing suppliers as well as customers.  
• Coordination of information and integration improve the overall flow of the chain.  
• Utilizes a process view to meet uncertain demand. | • Services do not have a return cycle.  
• Fits the product and component flow of goods. |

Source: Ellram, et.al., 2007
Appendix C

Company Interview Guide

General Information

1. What types of services does your company purchase? Please list 2 or 3 with highest spend.
   - What is your role within the organization? (i.e. Category Manager)
   - What type(s) of services do you personally procure and manage? (i.e. Engineering, IT, Legal, Plant Maintenance, Accounting, etc.)
   - Is this type of service perceived as important to top management?

2. Does your company procure both products and services?
   - What is the estimated spend breakdown? (i.e. 70% products, 30% services)
   - Do you have experience in both types of purchasing?

Processes & Practices

3. How do you select service suppliers? Please briefly outline the process.
   - Around how many providers occupy your category or sector?
   - Please rank the following factors by importance for your category
     - Quality
     - Cost
     - Delivery (adherence to agreement, timeline, etc.)
     - Other (___)
   - Which other functional groups are involved in the selection process?

4. What type of contractual agreement do you utilize? (i.e. what sections, length of term, payment scheme, renewal process etc.)
   - Who writes the specifications/statements of work?
   - What type of commercial/reimbursement model is followed? (i.e. hourly rates vs. reimbursable contract)
   - How do you evaluate/benchmark rates for competitiveness?

5. How do you forecast demand for the service?
   - Do you work with your suppliers on this?

6. How do you manage relationships with your service providers?
   - Are certain suppliers given higher priority and attention than others?
   - How often and via what medium do you meet? Formal/Informal?
   - Within your organization, who communicates with your supplier and what role do they play? (i.e. regional procurement handles day-to-day issues and VP of PSCM meets with suppliers’ top management)

7. How do you evaluate delivery and performance?
   - Do you utilize metrics, scorecards or KPIs? Please describe your current system including frequency, types of metrics, collection methods, etc.
   - Is supplier performance in any way tied to their profit or share of your business?
   - How do you deal with issues and poor performance? (i.e. Performance Improvement Plans, cut supplier, etc.)
   - Do you participate in joint improvement activities with your suppliers?
Perception and Challenges

1. Do you perceive a difference between the overall processes of purchasing services versus goods?
   - Do you believe that purchasing services is more complex than purchasing materials or visa versa?

2. What do you believe to be the most significant challenges in service acquisition?
   - Do you feel that your service providers profit unfairly in the current system?
   - Do you feel that your service providers are extremely trustworthy? If not, what issues do you have? (i.e. withholding information, expanding scope without approval, underreporting rework, billing/calculation errors, substitution of lower-skilled staff, etc.)

3. What do you think could be done to improve your service supply chain? (i.e. better statements of work, more frequent communication)
   - Is your organization currently involved in any initiatives to overcome the above challenges?

4. Please rate the following components of your organization’s service supply chain from 1 (extremely ineffective/inefficient) to 5 (extremely effective/efficient).

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supplier Selection (Question 3)</td>
<td></td>
</tr>
<tr>
<td>Contracts/Payment (Question 4)</td>
<td></td>
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<tr>
<td>Forecasting (Question 5)</td>
<td></td>
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<tr>
<td>Relationship Management (Question 6)</td>
<td></td>
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<tr>
<td>Performance/Quality (Question 7)</td>
<td></td>
</tr>
</tbody>
</table>
Appendix D

Kraljic Model with Examples

Examples:
- Travel Services
- Temporary Staffing
- Real Estate

Examples:
- Printing & Copying
- Utilities

Examples:
- Engineering Services
- Some IT Outsourcing
- R&D
- Legal Services

Leverage Items
- Large Volume Purchases
- Unit Cost Important
- Substitutes Available
- Many Equivalent Supplier Available

Strategic Items
- Unique Specifications or Value-Add
- Supplier Technology Critical
- Few Suppliers Available
- Difficult to Substitute

Non-Critical Items
- Commodities
- Easy to Find Substitute Products
- Many Supplier Available
- Limited Financial Impact

Bottleneck Items
- Unique Requirements
- Supplier’s Technology, Knowledge, Assets or Expertise Critical
- Scarcity of Supply or a Few Superior Suppliers
- Difficult to Substitute
- Difficult to Monitor and/or Measure Performance
- Hidden Action by Supplier Possible

Low Supply Risk/Complexity High

Sources: Tate, Wendy L., and Lisa M. Ellram, 2009
Works Cited


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Local Address: 300 Waukelani Dr. #2010  State College, PA 16801

EDUCATION:
The Pennsylvania State University University Park  May 2014
The Smeal College of Business; Schreyer Honors College
Bachelor of Science in Supply Chain and Information Systems
Minors in International Business and Spanish, Dean’s List (Fall 10-Fall 13)
Awarded the Pennsylvania State University Schreyer Scholarship for excellence in academics and leadership
Researching and developing a major-related honors thesis to be completed before graduation in May of 2014

ACTIVITIES:
Penn State Varsity Swimming Team  August 2010-October 2011
• Dedicated over twenty hours a week to practicing, conditioning and racing for one of the most competitive teams
in the Big Ten Conference
• Decided in Fall 2011 to leave the program in order to pursue a summer internship with BP and an opportunity to
study abroad in Barcelona, Spain

Penn State Student Chapter of APICS  August 2013-March 2014
• Attended weekly meetings and study sessions to prepare for the first of four exams for the CPIM certification
• Will take the first exam (Basics of Supply Chain Management) in March 2014

THON Rules & Regulations Committee Member  September 2013-February 2014
• Attended weekly security committee meetings in preparation for THON 2014 in February
• Provided the safety and security to families, dancers, spectators and volunteers during the event by regulating
event security and supporting safe fundraising efforts

PROFESSIONAL EXPERIENCE:
BP PSCM (Procurement and Supply Chain Management) Internship Houston, Texas  May-August 2012
• Worked collaboratively in BP’s Gulf of Mexico (GoM) PSCM Solutions team to gain an understanding of
Backbone, the Vendor Maintenance Process, Price books, SAP, Excel and BP’s general PSCM processes
• Assisted in completion of GVEN Migration by deleting or converting over 1200 legacy records into 2M records
• Analyzed three batches of tail spend suppliers (about 550 suppliers) by commodity, spend and asset level to
assist GoM PSCM in future supplier optimization efforts
• Interfaced with vendors to obtain tax and address information to assist in the Vendor Maintenance Process.
• Developed a process to illustrate the steps that should be taken after PSCM identifies a supplier as a candidate
for blocking due to low spend and/or transaction counts; this process will help coordinate technical authority,
PSCM Specialists, Category Management, Functional Specialists and the assets.

BP PSCM (Procurement and Supply Chain Management) Internship Houston, Texas  May-August 2013
• Supported BP’s Global Projects Organization (GPO) Engineering & Project Management Services (EPMS) Team
• Researched current conditions of Subsea EPMS market to support the Subsea Strategy Refresh by Identifying
major & minor players, conducting a Porter’s Five Forces Analysis and creating a Kraljic Model
• Analyzed EPMS Commercial Model & Commercial Renewal Process to identify opportunities for improvement
• Proposed changes to contract language within Contract Payment section of Global Agreements (GAs) to reduce
inconsistencies across the GAs & potential duplication of charges to BP
• Worked with Category Leads to develop a Commercial Renewal Process to support timely & efficient renewals.
• Identified 4 key benchmarking opportunities to support informed negotiations and ensure rate competitiveness.
• Incorporated benchmarking into Commercial Renewal Process
• Created a Quarterly Report Template for GA Holders to report resourcing & capacity to support work allocation.
• Updated Supplier Profiles for project end-users with inquiries about GA Holders

SKILLS:
Language: Proficient in Spanish – Spring 2013 in Barcelona, Spain. Earned a 4.0 in 16 credits of coursework taught
and completed in Spanish at Universitat Pompeu Fabra. Basic understanding of Japanese – resided in Tokyo for 2 years.
Technical: Intermediate-level skills in Excel, SAP & Ariba OneSource