

## **THE IMPACT OF PUBLIC FIRMS COMMERCIALISATION ON PURCHASING MANAGEMENT**

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**ABSTRACT.** Purchasing management has been recently focused by public organisations aiming to maximise its contribution to operations. Such an aspect has been emphasised by the impacts of on going commercialisation process in the network public service sector. This paper provides evidence of changes in purchasing management behaviour in public firms in the water supply sector. In particular, in Italy the firms, after a first phase of increasing attention to purchasing management and suppliers selection, slowly has come back to a clerical approach, maintaining an “arms-length” relationship with suppliers. A model for describing the oscillation of purchasing management within the firms is presented and an explanation of such an oscillation is suggested in terms of flow of power between technical management and political managers.

### **INTRODUCTION**

The increasing inadequacy of traditional public organisations in satisfying the customers requests have pushed toward the externalisation of public services provision. This mainly occurred in the network public services sector (NPS) where an international trend to contestability and market approach is clearly on-going. The underlying motivation of such a trend is that competition definitively results in improved outcomes such as greater efficiency, higher quality of service, a clearer focus on customers and better value for money (Brown, Ryan & Parker, 2000).

This approach has determined an orientation toward privatisation, although in some cases there has been evidence that the privatisation of

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utilities has caused a relevant decrease in workforce employment and increasing prices for the users. Therefore, in such a context, it would appear adequate to maintain the service provision in public hands, although the pressure for improved performances would require the application of efficiency, effectiveness, and economic criteria in public organisations. Such an approach can be pursued either through financially autonomous departments or through firms wholly publicly owned (both of them are, in Italy, called commercialisation).

Since all business area should contribute to apply the above-mentioned criteria, also the purchasing function has to be focused according to the new orientation that during the last 20 years has gradually emerged. In fact, such an area of activities has been moving forward from being considered a clerical function (with the ultimate purpose of buying as cheaply as possible) to be regarded today as a major strategic function (Gadde & Hakansson, 1994). It is questionable whether this strategic function is recognised worldwide (Erridge & Murray, 1998), but it is clear that it has an enormous potential that should be analysed in terms of how much value it adds to the firm if correctly aligned with other functions and contributes to the development of the business strategy as a whole (Cavinato, 1999). While there have been many contributions in literature on the role of the purchasing function in the private sector, only a limited number of studies focused on public sector and in particular on the utilities sector.

In Italy, where the legislative aspects in public services provision are predominant, the choice between privatisation/contracting-out and a softer "commercialisation" of public organisations entrusted with service provision has not been clearly done yet. Within such a framework, the present paper aims to contribute through a case-study approach to analyse how the changes in purchasing function management within water firms can be explained in terms of flow of power between technical management and political managers. In particular, after some introductory considerations on the pros and cons of privatisation or commercialisation approaches, the empirical evidence from the behaviour of commercialised water firms has been modeled for representing the evolution of the firms' management with regards to purchasing function when they adopted management practices typical of commercial sectors, while remaining in public hands.

## PRIVATISATION AND COMMERCIALISATION OF PUBLIC WATER FIRMS

Privatisation is now a major part of industrial policy in many developed and developing economies. Empirical studies on privatisation as a policy have confirmed that it is now in use worldwide with a wide range of effects (Meggison & Netter, 2001). Actually, the ownership displays a spectrum, not an either/or, and the degree of competition that is claimed to affect the firm's performance is independent from ownership, and eventually the internal environment changes of the organisation better explain the performance improvement (Parker, 1995).

With particular reference to the water services, decision makers are now under pressure all over the world to improve the quality of services provided, and therefore often the option to contract the operation of water systems to the private sector, usually through a concession or management contract, is increasingly considered appropriate.

Despite the well-known benefits expected from entrusting the service provision with private partners, there is need for exercising caution in extending its application to situations where both markets and government regulatory capacity may be weak, as in Italy. Commercialisation of public organisations in this context provides a way of developing commercial arrangements yet maintaining service delivery within the public sector and offers the possibility of retaining important social objectives (Sanderson, 1996). However, in this framework, politicians and bureaucrats push for maintaining the status quo that enable them to gain power through the control of the public organisations in charge of service provision (Ancarani & Raffa, 2001). The status quo here means that the focus of the public organisation remains on the application and in control of formalised procedures while less or no attention is devoted to analyse the results attained. A bureaucratic approach to organisation structure and a reactive style of management remain distinctive characteristics of these organisations.

Actually, the public firms "commercialisation" requires deep internal changes in order to gain better performance. To reap the changes of such a modification, management has to revitalise a culture based on years of political control and non-commercial values, taking into account that the values required to run a public service still remain different from those required for a business (Parker, 1995).

## THE PURCHASING FUNCTION IN PUBLIC SECTOR

The literature on public sector purchasing management is mainly about local government practices. It is argued that the application of private practices can be appropriate but may be inadequate. In other words, since the strategic goals of the “public sector” are fundamentally different and much wider ranging from those of private organisations, it is questioned whether private purchasing practices can be applied in the public sector and in public firms in order to improve their performances in terms of efficiency, effectiveness, and economy (Murray, 2001a, b).

The advantages of co-operative over adversarial relationships with suppliers have been stressed, and evidence has been shown that an increasing number of companies are adopting this practice (Anderson, 2001). However, some researches have shown that there are many different types of effective suppliers relationships that may vary from case to case (Ellis, 1997) and there is evidence that a mix of the two approaches has been successfully applied in government purchasing of goods (Erridge & Nondi, 1994).

From the literature review, it appears clear that nobody can claim that any form of external contractual relationship is superior to all others (Cox, 1996), since it depends strongly on business conditions and firms have to deal with the need for attaining an equilibrium between core competencies, internal and external relationship enabling them to gain a profitable margin. On such relationships, the influence of the European Union’s public procurement policy, which proposes to adopt competition in purchasing management, appears really strong, as it misses the importance of reliability, inter-personal understanding, and proximity to production sites. The consequences seem to be a focus on adoption of short-term price-competitive strategies.

Some authors contributed to the discussion on strategic public purchasing management by investigating how a firm can recognise the constant need for changes in boundaries in order to respond to customer requests (Cox, 1996), and how the purchasing function changes within the evolution of strategic management according to a five-stage path (Cavinato, 1999). However, there is evidence that in several cases purchasing strategies do not support business strategy, both in private and public firms. Furthermore, the possibility to contribute to overall strategy appears to be more frequent either within large-scale redundancy or downsizing programmes. The characteristics of the market strictly

impact the capability of the purchasing function to contribute as a strategic function since in monopolistic conditions it is quite easy to pass on to the customer the costs (Anderson, 2001).

In the water industry, the nature of the purchaser-supplier relationship varies according to the type of supply or service being procured. Public sector organisations and utilities companies are sensitive to the need to have close relationships with suppliers (particularly for main supplies like machine parts, conduits, etc.) both for continuing quality control and for enabling both buyer and supplier to develop long term strategies. However, the need to also match the European Community's (EC) prescriptions, determines promiscuity in purchasing management between competition and partnership sourcing (Furlong, Lamont & Cox, 1994).

Cox Harris and Parker (1998) identified major changes in purchasing management at two water firms in the UK since privatisation while there is evidence of a less mature approach to purchasing in a third water firm. In all three cases, purchasing management is seen as providing a value-added service to the rest of the organization, and the role of the head of procurement has widened.

### **THE EVOLUTION OF PURCHASING MANAGEMENT IN COMMERCIALISED WATER FIRMS IN ITALY**

Taking into account the important innovations in the institutional framework, related to water supply provision, the legislation has been introducing in the last decade, this study provides evidence of purchasing management changes in "commercialised" water firms in Italy. The research was based on three in-depth, descriptive case studies used cases validated internally by accordance with the explanation given by the relevant stakeholders within the firms. Some of the findings from the case studies were qualitatively tested through informal interviews with general managers of three other firms located in the central part of Italy.

The three analysed firms are located in Sicily and employ 36, 62, and 182 people. The procurement offices employ 2, 4 and 7 people, respectively. The first step of the analysis was based on a semi-structured questionnaire. The purchasing managers, general directors, managing directors, and presidents (the last two positions being nominated by politicians) were requested to fill-in the questionnaire. Then, in a second step, interviews with the above mentioned people and with others within

the staff were carried out in order to validate and test the internal environment feeling about some critical events and changes and about the explanation given by top managers.

In what follows some general considerations arising from the analysis of the questionnaires are reported. In its first phase of "commercialization," a public firm pays a great attention to purchasing management and suppliers selection; but due to the non-competitive market, the firm determined to gradually fall back to previous practice. There is evidence of a continuous bureaucratic approach for maintaining an "arms-length" relationship with suppliers. The EC procedures are applied for emphasising the formal aspects rather than for promoting an actual competition among suppliers.

What appears clearly from the interviews is that the substantial changes determined by the different strategic approaches to firm management seem to be all driven by cost-cutting pressures. The role of purchasing within the firms during the 1980s and early 1990s was considered strictly clerical, with processes carried out in a very archaic manner, without any strategic contribution to business. During middle and late 1990s, radical innovations in the institutional framework have been clearly oriented to introduce competition in water services. In such conditions the increasing pressure for value for money and quality, highlighted the role of functions previously disregarded, and among these of the purchasing function, although it remained as a money saving source rather than a strategic leverage.

These changes correspond to the first stage of the firm commercialisation. The firms needed to show themselves as reliable, competitive, efficient, and effective to be considered as a reliable partner in a sector experiencing a very strict rationalisation process. From the managerial point of view, the transformations are pushed by the need for focusing on core competencies and for reducing employment costs, thus determining a significant increase in activities outsourcing. However, the firms remained in the basic financial planning stage focused on the budgetary process with a short-time horizon. The procurement office was seen as simply providing items at a lower price and faster than before and the approach remained reactive for solving incoming problems.

In a second stage, emphasis was placed on forecasting and maintaining the most favourable price and the range of products acquired by the purchasing department was considerably expanded and included

raw materials, while the reactive approach remained predominant in problem solving processes. Since firms were unable to control the outsourced activities, the strategic plan required a substantial revision and some activities were retained in-house. Actually, in one of the analysed firms the purchasing manager was often involved in crisis resolution due to his experience, but when the crisis was solved his long-term suggestions were always forgotten.

While in several cases described in the literature, in the next stages improved strategic contributions of purchasing function were observed, in the analysed cases the interaction between managers and politicians, with the latest recovering power in the last years, worked as an inhibitor for the development of long term strategies and for the inclusion of the different area of the firm in the strategic processes. Thus, the evolution into externally oriented planning and strategic management was lost.

Therefore, a third stage was observed when the threat for competition was considered less critical, a come back to the basics has been observed, resulting from the relevant delays experienced in the application of the modified legal framework. These delays were mainly due to the number of obstacles that relevant stakeholders posed in order to maintain the status quo. In particular, with reference to the purchasing function, presidents and managing directors retained the relationship with main suppliers, while the other members of the staff were excluded from the relationships at all. Up to this stage the number and amount of outsourced activities remained limited.

The fourth stage is still in progress and it will develop according to the result of the fight between technical management and political managers. From a hand, the general director has been attempting to acquire competencies in control of outsourced activities and to retain power through a continuous training of the personnel; from the other hand the politicians have been pushing for employing less skilled people that can be entrusted just with low level jobs and in particular, in maintenance services. Hence, the politicians have been asking for internalised low level activities in order to justify the request for new job positions and push for externalising other activities involving in firm's processes external advisories that sometimes conflict with young internal personnel feeling overcome by them.

## A MODEL FOR ANALYSING PURCHASING MANAGEMENT IN WATER FIRMS

In order to generalise the behaviour of the analysed firms, and to take into account the outcome of the qualitative analysis, a model for describing how the approach with procurement in commercialised public firms in water industry evolves has been developed.

A scheme of such a behaviour of a commercialised firm is represented in Figure 1. The starting point is considered the bureaucratic, wasteful, and inefficient approach, traditionally attributed to the public sector. Such a first stage is termed "clerical". In this stage the political involvement is high, while the pressure on cost reduction is low, as well as the level of external competitive pressure.

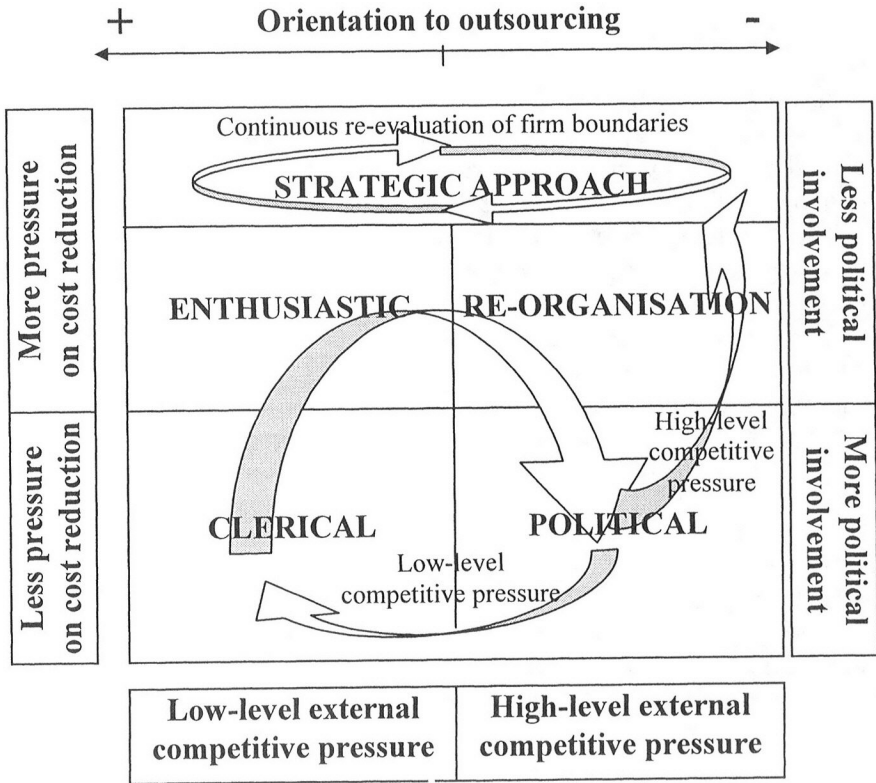
When both the amount of public money available for investment is reduced and efficiency and quality in public services provision is increasingly required by citizens, a first step up to the stage termed "enthusiastic," is identified. The managers try to cut the costs through a general re-discussion of the contracts and to outsource as many services as possible. In this stage, the politicians are less involved and are oriented to lose power in favour of the new managers who are selected on competencies bases.

Two main strategies parallel the outsourcing strategy, namely a strong reduction of non-strategic personnel, through incentives to retirement, and a focus on cost-reduction activities, including purchasing and supply management. Oldest people are left behind in gaining power by new management and people with a positive attitude toward innovation.

As the competitive pressure increases, a second step brings to a next stage termed "re-organisation", in which young engineers and technicians are employed. There is a transfer of power between senior engineers and young engineers; often the seniors are stressed by the rhythm of changes and are oriented to retire. When this happens, since the young people are not well experienced, a lot of work remains in charge of the general director who is strongly pressed by operation management instead to be devoted to define the strategic management. Part of the services are again internalised mainly due to the lack of skilled people in control procedure. However, an attention to cost reduction is maintained above all in purchasing main materials, namely products with the longest life such as conduits, valves, etc.



**FIGURE 1**  
**Evolution of Public Service Firms in Purchasing and Supply Management Strategies**



In this stage the firm starts to be profitable, and a third step toward a stage termed “political” can be identified. The politicians try to recover their power and management is confined to technical aspects while the strategic decisions are taken at political level. Generally, the pressure for cost reduction is reduced. The control on suppliers is relaxed. Due to the need to show itself as really active (the level of competitive pressure remains high), the firm is involved in a lot of activities, the number of employees increases, and a number of construction works are on-going. Nevertheless, the approach to purchasing management remains reactive

although the management complexity would require a proactive approach.

The next steps are strongly affected by the external environment and particularly by the competitive pressure for the market. If the competitive pressure decreases, a comeback to the “clerical” stage can be observed when the number of non-technical employees increases even more, the personnel selection is made on political bases, and the most skilled technical management is encouraged to leave the firm. Support and ancillary activities are outsourced, and also the control on costs is more relaxed than in the previous stage. If the competitive pressure remains high, the profitability of the firms depends on the cost reduction activities and on the appropriate management of the support services. Since the politicians have no skills on such problems, the technical managers retain power and a strategic approach to purchasing function should be achieved due to the interactions between purchasing manager and general manager, while the level of outsourced activities depends on a continuous re-evaluation of the firm’s boundaries.

### CONCLUSIONS

The analysis carried out in the present paper pointed out an oscillation between outsourcing and internalisation of the activities pushed by political involvement, needs for cost reduction, and competitive pressure rather than by an increased or advanced contribution to business strategy of the purchasing function. It remains almost as a support function whose importance is determined by cost and competitive pressures.

A model for describing the oscillation of the purchasing management within commercialised public firms has been presented and an explanation of such oscillation has been done in terms of flow of power between technical and political managers. The model describes in detail the behaviour of a small sample of firms, but it might be considered appropriate as well for describing the role of the purchasing function in the whole water sector in Italy, where it is not clear whether it is more valuable to outsource some activities or not. While many limitations on the analysis must be recognised, it is nevertheless argued that the flow of power between managers and politicians in determining strategic orientation in public firms should be attentively focused for describing the behaviour of the Italian water firms. Therefore, the outlined findings

can be considered useful for providing an insight into how purchasing management is presently carried out in public commercialised organisations when the competition pressure is not high.

The unsolved question remains whether strategic management in public sector should be considered a political choice or a procedural and organisational design. In the latter case, all business area should support the overall strategy, above all those areas where there is room for reducing costs. On the contrary, in the former case the value for money approach is less important and politicians prefer to handle by themselves the relationships with main suppliers, disregarding competition or management excellence. This approach, if correctly applied, could lead to more appropriate long-term relationships thus reducing the importance of cost reduction effect and increasing the collaboration with suppliers. However, there is evidence that such positive effects can be gained only in two cases. The first case occurs when the politicians have a technical skill allowing them to average the social-political needs with technical-managerial ones. Since this barely occurs, generally the result of this approach is a reduced pressure on suppliers, increasing costs, and dependence from main suppliers. The second case occurs when the competitive pressure pushes politicians to find an agreement with technical managers leaving them the operations and handling together the strategic issues. In this case, it seems reasonable that the purchasing function should gain a strategic relevance.

In general terms, a strategic approach to external resources management seems presently to be far from public managers aims, mainly due to the political constraints. Purchasing as an activity has increased in its importance and control, while purchasing strategies have not evolved or supported the business strategy as a result of commercialisation. Nor does commercialisation encourage the development of purchasing strategies towards closer relationships with suppliers, where the competitive pressure is low.

What will happen in the future when the competitive pressure should increase? Will it be possible that the politicians would leave again power to technical managers? Both questions cannot be easily answered due to the number of variables affecting the decision of the relevant stakeholders, even if the proposed model would point out that the competitive pressure should lead to a strategic approach to purchasing management as a competitive leverage. However, it appears a problem of balance between technical and political powers rather than of ownership.

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