

PURCHASING VERSUS THE BUDGET

FIRST PUBLISHED IN SUPPLY MANAGEMENT SEPTEMBER 2003

If you believe budgets are an accountant's problem, think again: they might be giving budget holders little incentive to work with you, argues **Andy Williams**



As a Purchasing professional keen to achieve value-for-money, do you ever wonder why your customers, the Budget holders, seem lukewarm if not actively hostile to offers of help? If so you're not alone. Many organisations have worked hard to raise Purchasing skill levels and yet appear reluctant to reap the benefits.

The Problem

The answer may well lie in that word "Budget". Their use to plan spending is so familiar that we rarely question it. Indeed, they are invaluable. However Budgets also affect expectations and behaviour in ways which work against achieving best value.

Looking at some very typical problems, two, Budget Anchoring and Sub Optimisation, are about perceptions of cost. The others, Savings Denial, Lost Savings, Stolen Savings and the Budget Dump, concern internal competition over money.

Budget Anchoring

Budget Anchoring works like this; Budget Holder X plans a new piece of equipment next year and approaches a supplier for a "Budgetary Quote" (which certainly includes negotiating margins.) Since this is hypothetical nobody has the time or inclination to negotiate seriously. Crucially, the supplier has anchored expectations. Later, if the formal

PURCHASING VERSUS THE BUDGET

PAGE 2

quote is on or below the budget we relax. Otherwise Purchasing may be asked to reduce the price, hopefully to the original figure, and everyone is happy; X's budget is safe, Purchasing claim a saving, and the supplier gets his money. Rarely is the original anchor value questioned.

Sub Optimisation

X may have chosen this supplier because his interest is in only part of total costs, usually the purchase price, while other budgets bear the remainder such as maintenance, poor quality or excess administration. This is a sub-optimal choice, but difficult to change if the organisation has no way of measuring total cost.

This problem is exacerbated if

- a. Suppliers understand and manipulate perceptions of cost accordingly.
- b. Savings targets only look at the price.

Savings Denial

Many organisations see Purchasing purely as about saving money, therefore increasing profits. If the money is spent elsewhere, profits remain unchanged, so there is no saving. No matter how great the cost reduction, Purchasing are credited with nothing. We call this Savings Denial and it is a truly effective deterrent to saving money.

Lost & Stolen Savings

When budget holders know savings will be lost to them rather than carried forward, or 'stolen' by another department (Finance) they see no obvious benefit. Indeed, under-spend may create pressure from above to reduce future budgets. The logical response is

- a. Spend *all* the Budget.
- b. Avoid price reductions. Better that suppliers add features and accessories instead.

To quote one purchasing manager; "I am new here and could save a lot of money. My boss (Finance) insists this must be through rebates payable to his department. Budget Holders don't seem to be co-operating".

The Budget Dump

Dumping Budgets is a favourite way to avoid Lost or Stolen savings. As financial year end looms and there is money left, Budget Holders can lose it, spend it in a hurry or persuade a supplier to "look after" it. Hurried purchase orders and invoices are a feature.

A supplier who

- a. now has your money
 - b. knows you have probably broken your company's rules
- is in a position of strength.

What to Do?

Many Purchasing people say "Budgets are an accountant's problem, not ours" Not true. If the Budgeting Process means that our colleagues have no incentive to work with us or worse, see us as a threat, we have to change that. It is essential that we work with Finance to ensure

- a. That the Budget is seen for what it is, a planning tool, and not as a negotiating target or, worse, the minimum amount Budget Holders should spend.
- b. That we have a process for scrutinising "Budgetary Quotes"
- c. That we make decisions based on total cost
- d. That Budget Holders benefit from Savings

Finally, bear in mind that when colleagues seem less than eager to benefit from our Purchasing prowess, there's often a good reason.