McKinsey&Company
Operations Extranet

March 2015

Finding the right size for the purchasing organization

Is your purchasing organization suffering as a result of past resource allocation mistakes? It might be time to start with a clean sheet.

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How does the size of your purchasing organization compare with that of your competitors? How does it match up against comparable businesses in other sectors? Today you have access to plenty of benchmarks—including McKinsey's GPE survey[1]—that let you make such assessments. But the headline figures don't tell the whole story. They describe a macro picture, but can't take into account the specific requirements of individual companies.

Purchasing functions are complex entities. Companies don't just need to decide how many people they need to achieve their purchasing goals. They also need to consider the split between "strategic buyers," who are responsible for developing and implementing category strategies, selecting suppliers, negotiating contracts, and managing supplier relationships and category performance; and "operational buyers," who manage day-to-day orders and the challenges around deliveries and payments. An organization must also choose how responsibility will be shared between the central purchasing function and individual business units or regions. To complicate matters further, the right answer to each of these decisions may vary by category and depend on the nature of demand and supply market dynamics in each of these groups.

As a result of all this complexity, many organizations have an imperfect approach to the sizing of their purchasing functions. If a company needs to cut costs, the inability to see where purchasing staff are most critical to performance can lead to the imposition of blanket headcount reductions, which often hit the weakest areas hardest. A business or category left with too few purchasing personnel can easily lose more through poor spend effectiveness than it saves by headcount reduction.

On the other hand, many of today's purchasing organizations are the result of years of organic growth—with extra personnel allocated to the categories or business units where the call for resources has been loudest. This leads to waste. Some categories or businesses may be over-staffed, even though there are limited savings or performance gains left to capture. Other areas, meanwhile, may lack the resources to do an effective job.

And if the current organization is flawed, the problem is exacerbated when companies need to make changes. Shifts in market conditions, business structure or purchasing portfolio may take a long time to be reflected in the purchasing organization. The success of attempts to

1 The McKinsey Global Purchasing Excellence survey:
https://operations-extranet.mckinsey.com/download/publication/20100309_global_purchasing_excellence_brochure.pdf

evolve the structure of the purchasing organization, meanwhile, can be hampered if the new organization inherits inappropriately allocated resources from the old one.

Starting from a clean sheet

What if there was a different approach to purchasing organization sizing? What if organizations started by asking exactly what the purchasing organization has to achieve and then allocated the appropriate resources to meet those needs? This bottom-up, or greenfield approach could not hope to precisely capture all the varying requirements of different categories and business units, but it could provide a useful complement to conventional benchmarking approaches. It would help drive the organization towards fact-based discussions, rather than gut-feeling assertions.

Let’s look at how such an approach would work in practice. In this article, we’ll focus on the core strategic and operational purchasing activities. However, the same principles could be extended to other parts of the purchasing function, like supplier quality management, for example.

To determine the size of the purchasing organization from the bottom up, a company needs to start with some basic design criteria. A great first step for this aspect (and many others) of good purchasing practices is a robust category tree (Exhibit 1). In our view, strong category trees share a few common characteristics.

First, good trees are defined by the characteristics of the supply market, not the consuming organization. Plastics would be grouped together, for example, even if they are used for very different purposes by different business units. Grouping this way enables companies to capture economies of scale in the goods and services they purchase and to benefit from economies of skill within the purchasing organization.

Second, ultimate responsibility for a category should rest with one individual in the organization. In some companies, this will be a member of the central purchasing organization. In others, a lead buyer will be associated with a particular business unit. Either way, this single point of responsibility helps to capture those vital economies of scale and skill.

Finally, there are a limited number of overall categories in the tree. This helps keep the complexity of the purchasing organization under control. It also aids in sharing standards and best practices across related categories, and ensures individual purchasing units are big enough to be effective.

Exhibit 1: A strong purchasing category tree rolls up like spend items into a limited number of logical groups

Main category	Product	Main category	Product
a. **General expenses (30%)**	Fleet Consulting Office supplies Insurance Travel	d. **Technical services (15%)**	Engineering services Industrial cleaning Mechanical maintenance Electrical maintenance Civil engineering Waste management
b. **Packaging (20%)**	Big bags Drums Label Pallet	e. **Technical materials (10%)**	Lab equipment Pipes Pump and compressor Maintenance and repair spare parts Filters Electrical equipment
c. **IT (15%)**	Fixed phones Mobile phones PC hardware PC software IT outsourcing	f. **Energy (10%)**	Electricity Gas Fuel

Source: McKinsey analysis

Sizing the strategic purchasing organization

The characteristics of the products and services in the category tree determine the number, type and location of the strategic buyers needed to support them. Companies can look at these characteristics across two dimensions:

1. Whether a product's **supply market** is ***global*** or ***local***. A global supply market, like PC hardware, can be negotiated by a single central team. A fragmented, local supply market, like maintenance, will have to be negotiated separately in different regions requiring specific local market knowledge.
2. Whether the **demand profile** of the product or service purchased is ***simple*** or ***complex***. Where products and services have a narrow range of specifications or usage patterns, like electricity supply or IT consumables, it makes sense to develop a single central sourcing strategy. Other products, like packaging, by contrast may have widely varying characteristics according to their end use, requiring different strategies at the local, group or business unit level.

Breaking down the characteristics of categories in this way allows companies to identify the best approach for the strategic purchasing activities associated with each: how and where the category strategy is defined, and how supplier negotiations are conducted. A product with consistent demand characteristics, but a fragmented supply market, like facilities management, for example, will be best managed with central strategy definition, but local supplier negotiations (Exhibit 2).

Exhibit 2: The supply and demand characteristics of different product categories and their influence on procurement and negotiation strategies

(i) Strategy definition (ii) Supplier negotiations

Supply market
Is the supply base global, local, or fragmented?

Supply market	Complex	Simple
Global	**Locally or BU[1] defined, but globally managed** (i) Global demand and strategy definition (ii) Hybrid supplier negotiation model, balancing central and local requirements	**Globally defined and managed** (i) Global demand and strategy definition (ii) Centralized supplier negotiations
Local	**Locally or BU defined and managed** (i) BU or local demand definition (ii) Local supplier negotiations	**Globally defined, but locally managed** (i) Global demand and strategy definition (ii) Local supplier negotiations

Demand
Do BUs or regions require different solutions, or is the demand pattern significantly different across them?

[1]Business unit.

Source: McKinsey analysis

Once companies have identified the most appropriate approach per category, the next step is to define the manpower required to deliver that strategy. That’s not a straightforward process, however. Organizations need to take into account the work required to research, refine, and develop strategies, and to identify and select and manage suppliers and negotiate contracts to deliver those strategies. They need to consider how strategic purchasers split their time between these activities and their other responsibilities. Establishing requirements in this way makes it clear exactly what the function needs to deliver and the resources required to do that. Building on the outcome of that analysis, the company can allocate a number of strategic buyers to each category based upon the chosen approach and the frequency of sourcing cycles in the category.

Sizing the operational purchasing organization

Purchasing isn't all about strategy, of course. Execution matters just as much, and sometimes even more. If an organization has a clear split between strategic and transactional roles, then the right number of people required to run day-to-day purchasing operations in each category depends mainly on the number of line items processed every year, the degree to which those orders have been automated, and the time required to manually process and validate non-automated orders.

This information can be obtained from historical purchasing data. As the performance of individual buyers can vary significantly, however, it is wise to set an ambitious baseline. Companies might consider using top quartile buyer performance to define expectations, for example, assuming that training, coaching and process improvement will bring all buyers up to this level in due course. Where purchasing staff tend to take both roles, companies will want to use a hybrid of the two models, with a certain fraction of each buyer's time allocated to different categories.

Refining the model

Organization sizing models like the one described here provide a great first estimate of the appropriate number and allocation of purchasing personnel in a business. Inevitably, however, they will need further refinement before organizational changes are made. Most organizations will conduct this refinement in an iterative way in collaboration with members of their current purchasing organization and the key stakeholders in the individual business units they will draw upon additional sources of data too, like those familiar external benchmarks.

There are a number of characteristics that can change the demands placed on a purchasing organization in particular categories. These include the size of spend in that category, the number of products managed and the number of potential suppliers active in the market. Internal characteristics can matter, too. Some business units may have highly specific demands that make sourcing in certain categories more challenging, for example.

Our experience of companies that have used this sort of sizing methodology suggests that the ultimate degree of refinement required can be surprisingly small. At one organization, for example, the initial results of the model were within 5 percent of the numbers eventually validated and selected across the organization. In fact, a large discrepancy between the number of purchasing staff suggested by the model and that demanded by the business may be an indicator of some separate underlying issue, like inefficiencies in internal demand management or poor supplier relationships. Recognizing these discrepancies can foster hypothesis-driven discussions to address such issues. Often, the best solution is a change of processes, mind-sets or capabilities, rather than additional personnel.

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People are fundamental to an organization's purchasing performance, and changes to culture and capabilities will most often be the most powerful way to improve that performance. But many companies also struggle to ensure that they have the right number of purchasing staff in the right areas of the business. The kind of analysis described in this article is one way to make these difficult resource allocation decisions more fact-based, and ultimately, more equitable■

Join the discussion! What mechanisms does your organization use to size its purchasing function, and allocate resources? Please add your comments using the link provided on the Operations Extranet web page for this article (at the top of the article, if you are reading this on a browser).

Organization sizing is a topic that comes up with increasing frequency in our conversations with senior purchasing executives. If you'd be interested in participating in a roundtable discussion on this topic with other leaders, contact the authors directly using the links on the right of the Operations Extranet web page for this article (this page, if you are reading this on a browser).

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