


What's it all about: **Why you shouldn't go for lowest cost when buying services.**
Reading time: **18 minutes.**
What's in it for you: **Do your homework and clean up your act!**

The impossible art of buying business services

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» Early in 2010 the Netherlands were hit by a sudden, nation-wide strike of cleaning personnel. The main reason was protest against low pay. Furthermore, staff complained about the limited resources available to do their job properly.

As reports showed, cleaning personnel were paid minimal wages, whilst employers saved on cleaning materials and equipment. Cleaning materials were supplied at the beginning of the month. But half way through that period, all supplies were consumed and cleaning staff had to do without.

As a consequence of the strike, garbage piled up in stations, streets and offices. When interviewed, cleaning providers complained about the relentless cost pressure from purchasing managers. Intense price competition in tenders gave them very little room to manoeuvre and forced them to accept contracts below cost price. Cleaning providers said they had no option, in order to survive, other than to reduce salaries, hire inexperienced staff and cut on supplies. When asked how to make profits in such a situation, one employer said: "We just put less hours into the job. Many clients know this. Some clients don't mind since they do not follow up on our activities".

A difficult category

This example shows a range of problems related to buying services. Business services - i.e. services that are exchanged between organisations - have become a substantial element

in firms' total purchasing spend. In general, buying business services is considered to be totally different from the purchase of goods. Firstly, services are heterogeneous, which implies high diversity: purchases may range from buying simple taxi transport to contracting complex marketing and software services. As a result, each purchase seems to require its own approach. Secondly, services are consumed at the moment that they are produced, which implies that services require a close collaboration between buyer and seller. As a result, service quality is a joint responsibility between buyer and service provider. Thirdly, if services are not consumed at the time of production, the service is lost. In other words: services cannot be put on stock; they are perishable. Finally, intangibility complicates the evaluation of service quality, both in advance of the purchase when evaluating alternative service offerings, and after the purchase when evaluating service (provider) performance. These issues are particularly true for so-called professional services like accountancy, tax consultancy, IT services, HR services and management consultancy. These services highly rely on knowledge on the side of the provider, which is difficult to objectify and measure.

Higher risk

Due to these characteristics, risks related to buying services are considered to be higher than when buying goods. Buyers report experiencing more risks and problems related to specifying services, qualifying and selecting

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service providers and evaluating the performance of service providers. Surprisingly, some researchers found that CEOs deem the purchase of services to be easier than the purchase of goods, tending to assign new or inexperienced buyers to deal with services contracts.

Going for cost or value?

These observations may explain why other researchers have found that the purchasing department is much more likely to be by-passed when services rather than goods are being purchased. In many companies, services are seen as non-strategic and are often bought indiscriminately. The services that are regarded as important and strategic are, on most occasions, bought by non-purchasing specialists (advertising agencies by marketers, accountants by financial managers). These internal customers usually have strong personal relationships with their suppliers, with which they do not want purchasing professionals to interfere.

The traditional way in which the buying of services is organised and the specific problems that surround them, explains why cost savings potential is high. This

may explain why cost reduction has become a prime issue in buying services today. However, as the introductory case shows, pursuing a pure cost focus when contracting for services may not always be appropriate. Rather than going for lower cost, buyers should explore the opportunities for increasing profits and value. The benefits of such an approach may be equally large. This is particularly true when the contracted services are part of the company's value proposition to its customers.

Part of your brand, too

In many cases the services that are contracted for are part of the company's value proposition. Think for example of luggage handling at airports. This handling process is usually outsourced by airlines to specialist providers. The service provided by these external specialists is part of the offering of the airline to its passengers. In case luggage is lost, passengers will hold the airline accountable, even though they might know that it is not actually the airline that is handling the luggage. The same applies to for example cleaning services contracted by national railway operators. The cleaning of trains and train stations has a



» **Buyer and supplier agreed on KPIs which measured a joint performance.**«

high impact on the traveller's experience. Dirty toilets, garbage in the alleys or non-emptied bins may negatively impact the customer's travel experience and satisfaction with the railway operator.

The two examples discussed above relate to services that usually are considered to be "hygiene factors". In case the suppliers meet the travellers' expectations nothing happens. But if they fail to do so, it may backfire on the companies that contracted these services out. It is therefore important to pay great attention to how these kinds of services are being contracted for.

Procurement should help, not rule

So: when your suppliers are part of your company's value proposition, they will impact your customers' satisfaction. In such a situation, it is highly important to involve the company's marketing experts and business managers actively in the sourcing process. Think for example of contracting for call centre services, where call centre employees are in direct contact with your customers, or for maintenance performed on advanced capi-

tal equipment at the customer's premises. Given the specific nature of these services, it will be impossible for buyers to contract for these kinds of services on their own. After landing the contract, the business will be responsible for working together with the service provider. Therefore, it should be their decision who to select and how to contract the service provider. This places the buyer of services in a coordinating and supporting role.

Right governance

Therefore, when buying services, a prime task for the purchasing professional is to put the right governance structure in place for monitoring the encounters between the service providers and internal company staff. Relationship management and contract management should provide for such governance. Studies into services buying suggest that active contract management is a key success factor for successful services purchasing. Buying companies that had defined and designed their daily activities with the supplier in detail (in terms of people involved, communication channels, media to

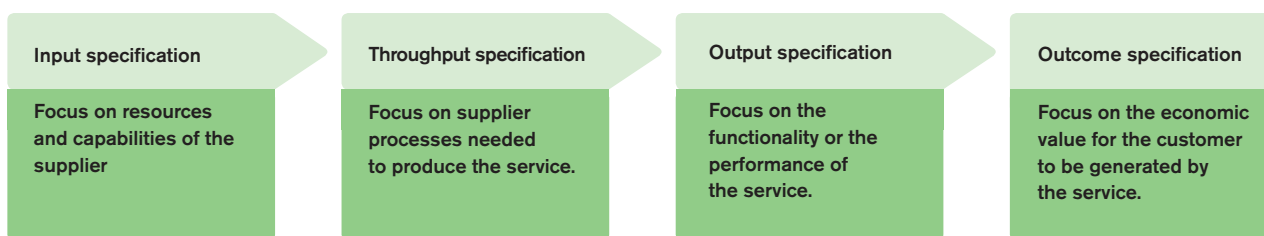
Four steps to better services procurement

When buying services, a unilateral focus on cost reduction may have dramatic effects on the reputation of the company, the service provider's profitability and the motivation of its staff. This is particularly true for those services that make up part of the company's value proposition to its end customers. Whether these services are possible cause for complaint or potential order-winners, they should be contracted with great care:

1. Think about what kind of service you are actually buying: is it part of your company's value proposition or not?
2. If so, set up a cross-functional sourcing team in which users are in the lead and procurement has a facilitating role;
3. Qualify suppliers using input and throughput criteria, be sure to include critical supplier capabilities;
4. Focus the contract on output and preferably outcome criteria, the supplier's expected performance should be the main award criterion.

When doing so, the services buyer will create a perfect alignment between the company's interest and the supplier's interests in the exchange. This will require a close collaboration between the buyer and the internal company's staff, as well as with the provider. Experience shows that this will not only result in lower organisational costs, but also in a better value contribution to the company's customers.

Figure 1: Methods for specifying business services (adapted from Wynstra and Axelsson).



» Service quality is a joint responsibility between buyer and service provider.«

be used and topics to be discussed), experienced fewer problems during the contract period and were relatively more satisfied with both the process of service delivery and the service outcome.

Define value

Let's reflect on the example of the railway's operator's cleaning services to see what design could have been put in place. The cleaning service directly affects the travel experience of the railway travellers. One way to create alignment between the interests of the railway company and the service provider is to link actual payment to the outcome of the service exchange, i.e. traveller satisfaction. Doing so has clear implications for what performance evaluation criteria to use. Rather than focusing on square meter of train surface cleaned (i.e. the output of the service exchange), the railway company may wish to focus on customers' satisfaction with regard to the cleanliness of trains and stations. The railway operator could then challenge the supplier to come up with an effective and cost-efficient cleaning program (i.e. the process underlying the service exchange) that will result in the desired level of customer satisfaction. When engaging in a discussion on this, it may be wise to involve the railway operator's marketing experts in setting up measures for traveller satisfaction. Currently, one European railway operator is experimenting with focusing their cleaning activities on washing the train's windows while the train is at the station. This idea resulted from a discussion among the operator's staff and experts of the cleaning company. It is an example of how two parties jointly look for innovative ways to improve the service offering and value proposition for the ultimate customer that they both serve, i.e. the train traveller.

During the discussions among the railway operator's and cleaning company's staff a number of issues and ideas emerged. The CPO of the railway operator suggested

that, from a traveller point of view, it would probably be best if cleaning personnel would have their breaks out of sight of the traveller. Otherwise, travellers could feel that cleaners were just hanging around, doing nothing. Cleaning staff indicated that they were frequently asked when and where a train would leave for a certain destination. To be able to respond, they should be knowledgeable about the timetable of the railway operator, or at least be able to direct the passenger to a point where information can be obtained. As the discussion went on, it became clear that cleaning staff could act as the railway operator's ambassadors and actually already were acting as such! Therefore, cleaning staff should be able to fluently speak the national language. As a result of these discussions, the railway operator put into their requirements that cleaning personnel should be provided with language training in addition to service-related training.

Agree on joint KPIs

Another result was that both companies agreed on KPIs which measured a joint performance, such as traveller satisfaction. This traveller satisfaction is not only the result of the cleaning crew performing well, but also of the railway operator running the trains according to the time table: a late train after all does not allow the cleaning crew sufficient time to do all the work required and with sufficient quality.

When contracting for services, qualification criteria for service providers should therefore be related to input variables and process variables, underlying the future service exchange. Award criteria should relate to the output variables and preferably on the intended outcome of the service exchange (Fig. 1). EP

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