

Learning chapters on project procurement management

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Nine months later her company was still paying high consulting fees, and half of the original consultants on the project had been replaced with new people. One new consultant had graduated from college only two months before and had extremely poor communications skills. Maria's Internal staff complained that they were wasting time training some of these "experienced professionals." Marie talked to her company's purchasing manager about the contract, fees, and special clauses that might be relevant to the problems they were experiencing. Marie was dismayed at how difficult it was to interpret the contract. It was very long and obviously written by someone with a legal background.

When she asked what her company could do since the consulting firm was not following its proposal, the purchasing manager stated that the proposal was not part of the official contract. Maria's company was paying for time and materials, not specific deliverables. There was no clause stating the minimum experience level required for the consultants, nor were there penalty clauses for not completing the work on time. There was a termination clause, however, meaning the company could terminate the contract. Marie wondered why her company had signed such a poor contract. Was there a better way to deal with procuring services from outside the company?

Although global outsourcing displaces some IT workers, total employment in the United States increases, according to IOTA, as the benefits ripple through the creates over 257, 000 net new jobs in 2005 and is expected to create over 337, 000 net new jobs by 2012. Politicians debate on whether offshore

outsourcing helps their own country or not. Andy Boor, chief operating officer of a computer network support service provider, describes outsourcing as an essential part of a healthy business diet. He describes good vs.. Bad outsourcing as something like good vs.. Bad cholesterol. He says that most people view offshore outsourcing as being bad because it takes Jobs away from domestic workers. However, many companies are realizing that they can use offshore outsourcing and create more Jobs at home. For example, Atlanta-based Delta Air

Lines created 1, 000 call-center Jobs in India in 2003, saving \$25 million, which enabled it to add 1, 200 Job positions for reservations and sales agents in the United States. 2 Other companies, like Wall-Mart, successfully manage the majority of their informationtechnologyprojects in-house with very little commercial software and no outsourcing at all. (See the Suggested Reading on the companion Web site on " Wall- Mart's Way. ") Deciding whether to outsource, what to outsource, and how to outsource are important topics for many organizations throughout the world. In a 2008 survey, 74 percent of 600 global procurement executives believed that recruitment issues are a high priority for their companies.

About half of respondents also said that their companies focus too much on cost reduction instead of value creation. They also believe they are missing opportunities by not focusing on using technology to improve procurement processes. For example, 72 percent of respondents " have less than 10 percent of their spend channeled through procurement and sourcing applications. 3 Most organizations use some form of outsourcing to meet

their information technology needs, spending most money within their own country. A 2008 report on IT outsourcing trends in the U. S. And Canada revealed the following: ; Application development is the most popular form of IT outsourcing and was used by 53 percent of organizations surveyed.

Of the surveyed organizations, 44 percent outsourced application maintenance, 40 percent outsourced Web site or e-commerce systems, and 37 percent outsourced disaster recovery services. The IT function with the largest percentage of work outsourced is disaster recovery services, accounting for 50 percent of total IT outsourcing. Organizations see the benefit in having an outside party perform offsets storage or maintenance of a recovery facility. Desktop support is the second most outsourced IT function (48 percent), followed closely by data center operations and help desk (47 percent each) and Web site or e-commerce systems (46 percent). IT security is at the bottom of the list, with only 29 percent of the work being outsourced.

Even though application development and maintenance are frequently outsourced, they are a low percentage of the amount of total IT work outsourced. Application development and maintenance are often outsourced selectively since most organizations choose to do many projects in-house. 4 Procurement means acquiring goods and/or services from an outside source. The term procurement is widely used in government; many private companies use the terms purchasing and outsourcing. Organizations or individuals who provide procurement services are referred to as suppliers, vendors, contractors, subcontractors, or sellers, with suppliers being the

most widely used term. Many information technology projects involve the use of goods and services from outside the organization.

As described in Chapter 2, outsourcing has become a hot topic for research and debate, especially the implication of outsourcing to other countries, referred to as offspring. The outsourcing statistics below are from an Information Technology Association of America (IOTA)-sponsored report: Spending for global sources of computer software and services is expected to grow at a compound annual rate of about 20 percent, increasing from about \$15 billion in 2005 to \$38 billion in 2010. Total savings from offshore resources during the same time period are estimated to grow from \$8.7 billion to \$20.4 billion. The cost savings and use of offshore resources lower inflation, increase productivity, and lower interest rates, which boosts business and consumer spending and increases economic activity.

Chapter 12 Project Procurement Management Because outsourcing is a growing area, it is important for project managers to understand project procurement management. Many organizations are turning to outsourcing to: Reduce betrothed and recurrent costs. Outsourcing suppliers are often able to use economies of scale that may not be available to the client alone, especially for hardware and software. It can also be less expensive to outsource some labor costs to other organizations in the same country or offshore. Companies can also use outsourcing to reduce labor costs on projects by avoiding the costs of hiring, firing, and reassigning people to projects or paying their salaries when they are between projects. Allow the client organization to focus on its core business.

Most organizations are not in business to provide information technology services, yet many have spent valuable time and resources on information technology functions when they should have focused on core competencies such as marketing, customer service, and new product design. By outsourcing many information technology functions, employees can focus on jobs that are critical to the success of the organization. Access skills and technologies. Organizations can gain access to specific skills and technologies when they are required by using outside resources. For example, a project may require an expert in a particular field or require the use of expensive hardware or software for one particular month on a project. Planning for this procurement ensure that the needed skills or technology will be available for the project.

Provide flexibility. Outsourcing to provide extra staff during periods of peak workloads can be much more economical than trying to staff entire projects with internal resources. Many companies cite quicker flexibility in staffing as a key reason for outsourcing. Increase accountability. A well-written contract- a mutually binding agreement that obligates the seller to provide the specified products or services and obligates the buyer to pay for them-can clarify responsibilities and sharpen focus on key deliverables of a project. Because contracts are legally binding, there is more accountability for delivering the work as stated in the contract.

In December 2002, when Morgan Chase announced a tie-up with TTS, both companies celebrated a \$5 billion deal too big to bragged that the contract would be like a win-win situation would make money and Morgan Chase could push for

innovation. The entrant less than two years. However, in September 200 gear fit with Comparing Chaise's busting its existence because the pro news strategy. According to Austin rumination officer at Comparing Chi cutter is best for the long-term gar " We believe managing our own techno and success of our company as well a railroaders. " However, IBM said the can contract was simply a result of Comparing Chaise's merger earlier that year with Bank It tried to shrug off the loss of a large business deal. " The combined firm found its an abundance of IT assets," IBM spokesperson James Scales said. This decision w other business decisions related to the merger. 7 Outsourcing can also cause problems in other areas for companies and nations as a whole. For example, many people in Australia are concerned about outsourcing software development. " The Australian Computer Society says sending work offshore IT professionals, and diminish the nation's strategic technology capability. Another issue is security, which encompasses the protection of intellectual property, integrity of data, and the reliability of infrastructure in offshore locations. 7 The success of many information technology projects that use outside resources is often due to good project procurement management.

Project procurement management includes the processes required to acquire goods and services for a project from outside the performing organization. Organizations can be either the buyer or the seller of products or services under a contract. There are four main processes in project procurement management: Organizations must also consider reasons they might not want to outsource. When an organization outsourcer work, it often does not have

as much monitor over those aspects of projects that suppliers carry out. In addition, an organization could become too dependent on particular suppliers. If those suppliers went out of business or lost key personnel, it could cause great damage to a project.

Organizations must also be careful to protect strategic information that could become vulnerable in the hands of suppliers. According to Scott McNealy, CEO of Sun Microsystems, Inc. , " What you want to handle in-house is the stuff that gives you an edge over your competition-your core competencies. I call it your 'secret sauce. ' If you're on Wall Street and you have your own program for tracking and analyzing the market, you'll hang onto that. At Sun, we have a complex program for testing sorceresses designs, and we'll keep it. 5 Project teams must think carefully about procurement issues and make wise decisions based on the unique needs of their projects and organizations.

They can also change their minds on outsourcing as business conditions change. 2. 3. Planning procurements involves determining what to procure, when, and how. In procurement planning, one must decide what to outsource, determine the type of contract, and describe the work for potential sellers. Sellers are contractors, suppliers, or providers who provide goods and services to other organizations. Outputs of this process include a procurement management plan, statements of work, make-or-buy decisions, procurement documents, source selection criteria, and change requests. Conducting procurements involves obtaining seller responses, selecting sellers, and awarding contracts.

Outputs include selected sellers, procurement contract awards, resource calendars, change requests, and updates to the project management plan and other project documents. Administering procurements involves managing relationships with sellers, monitoring contract performance, and making changes as needed. The main outputs of this process are process asset updates, change requests, and project management plan updates. Closing procurements involves completion and settlement of each contract, including resolution of any open items. Outputs include closed procurements and organizational process asset updates. Figure 12-1 summarizes these processes and outputs, showing when they occur in a typical project.

Planning Process: Plan procurements Outputs: Procurement management plan, procurement statements of work, make-or-buy decisions, procurement documents, source selection criteria, and change requests 466 Executing Process: Conduct procurement Outputs: Selected sellers, procurement contract award, resource calendars, change requests, project management plan updates, project document updates Monitoring and Controlling Process: Administer procurements Outputs: Procurement documentation, organizational process asset updates, change requests, project management plan updates Closing Process: Close procurements Outputs: Closed procurements, organizational process asset updates Project Start Project Finish

FIGURE 12-1 Project procurement management summary

The Boots Company PL, a Nottingham, England, outsourced its information technology systems to Tiber 002. The Boots Company signed a ten-year deal expected to save \$203.9 million over that period compared to systems itself. IBM managed and developed The Boots

Comma cutter " from the mainframes to the tills in our 1, 400 stores, to the co , said spokesperson Francis Thomas. More than 400 Boots employees were on Vim's payroll but continued to work at Boots' head office, with extra IBM staff as needed. Thomas added, " The great thing about this is that if IBM has an expert in Singapore and [if} we need that is not uncommon moon for long contracts to be renegotiated, becoming either shorter or longer in length.

May 2006, Boots and IBM began discussing amendments to their contract because of Boots' IT infrastructure renewal program (including a new pharmacy system and roll) was complete. A Boots spokesman said that the company achieved its goal much quicker than planned. In contrast, in 2005 Boots renegotiated its EYE million, seven-year IT contract it initially signed in 2002 with Sans, extending it for another two years to 2011 in a EYE million deal. 9 It is also not uncommon to take advantage of competition in the changing marketplace for major procurements. In 2008, Boots announced that it had up to six different suppliers competing to supply its IT products and services over the next year. The company is keeping its business system management team and service management in-house, including helpdesk and project management. 10 Properly planning purchases and acquisitions and writing good contracts can also save organizations millions of dollars. Many companies centralize purchasing for products, such as personal computers, software, and printers, to earn special pricing discounts. For example, in the mid-2000s the U. S. Air Force awarded a five-year, multimillion-dollar contract to automate 15 Air Force Systems Command bases. The project manager and contracting officer decided to allow for a

unit pricing strategy for some items required in the contract, such as the workstations and printers.

By not requiring everything to be negotiated at a fixed cost, the winning supplier lowered its final bid by more than \$40 million. II Planning procurements involves identifying which project needs can best be met by using products or services outside the organization. It involves deciding whether to procure, how to procure, what to procure, how much to procure, and when to procure. An important output of this process is the make-or-buy decision. A make-or-buy decision is one in which an organization decides if it is in its best interests to make certain products or perform certain services inside the organization, or if it is better to buy them from an outside organization.

If there is no need to buy any products or services from outside the organization, then there is no need to perform any of the other procurement management processes. For many projects, properly outsourcing some information technology functions can be a great investment, as shown in the following examples of What Went Right. Inputs needed for planning procurement include the scope baseline, requirements documentation, teaming agreements, the risk register, risk-related contract decisions, activity resource requirements, the project schedule, activity cost estimates, the cost performance baseline, enterprise environmental factors, and organizational process assets.

For example, a large clothing company might consider outsourcing the delivery of, maintenance of, and basic user training and support for laptops supplied to its international sales and marketing force. If there were suppliers who could provide this service well at a reasonable price, it would make sense to outsource, because this could reduce fixed and recurring costs for the clothing company and let them focus on their core business of selling clothes. It is important to understand why a plan purchases and acquisitions. In the opening case, Maria's company hired outside consultants to help complete an operating system conversion project because it needed people with specialized skills for a short period of time. This is a common occurrence in many information technology projects.

It can be more effective to hire skilled consultants to perform specific tasks for a short period of time than to hire or keep employees on staff full time. However, it is also important to define clearly the scope of the project, the products, services, or results required, market conditions, and constraints and assumptions. In Maria's case, the scope of the project and services required were relatively clear, but her company may not have adequately discussed or documented the market conditions or constraints and assumptions involved in using the outside consultants. Were there many companies that provided consultants to do operating conversion projects similar to theirs? Did the project team investigate the background of the company that provided the consultants?

Did they list important constraints and assumptions for using the consultants, such as limiting the time that the consultants had to complete

the conversion project or the minimum years of experience for any consultant assigned to the project? It is very important to answer these types of questions before going into an outsourcing agreement. Dividing both sides by \$400, you get: which means that the purchase cost equals the lease cost in 30 days. So, if you need the equipment for less than 30 days, it would be more economical to lease it. If you need the equipment for more than 30 days, you should purchase it. In general, leasing is often cheaper for meeting short-term needs, but more expensive for long-term needs.

Expert Judgment Tools and Techniques for Planning Procurements There are several tools and techniques to help project managers and their teams in planning procurements, including make-or-buy analysis, expert judgment, and contract types. **Make-or-Buy Analysis** Make-or-buy analysis is a general management technique used to determine whether an organization should make or perform a particular product or service inside the organization or buy from someone else. This form of analysis involves estimating the internal costs of providing a product or service and comparing that estimate to the cost of outsourcing. Consider a company that has 1,000 international salespeople with laptops. Using make-or-buy analysis, the company would compare those services from an outside source.

If supplier quotes were less than its internal estimates, the company should definitely consider outsourcing the training and user support services.

Another common make-or-buy decision, though more complex, is whether a company should develop an application itself or purchase software from an outside source and customize it to the company's needs. Many organizations

also use make-or-buy analysis to decide if they should either purchase or lease items for a particular project. For example, suppose you need a piece of equipment for a project that has a purchase price of \$12,000. Assume it also had a daily operational cost of \$400. Suppose you could lease the same piece of equipment for \$800 per day, including the operational costs.

You can set up an equation in which the purchase cost equals the lease cost to determine when it makes sense financially to lease or buy the equipment.

In this example, d = the number of days you need the piece of equipment.

The equation would then be: Experts inside an organization and outside an organization could provide excellent advice in planning purchases and acquisitions. Project teams often need to consult experts within their organization as part of good business practice. Internal experts might suggest that the company in the above example could not provide quality training and user support for the 1,000 laptop users since the service involves so many people with different skill levels in so many different locations.

Experts in the company might also know that most of their competitors outsource this type of work and know who the qualified outside suppliers are.

It is also important to consult legal experts since contracts for outsourced work are legal agreements. Experts outside the company, including potential suppliers themselves, can also provide expert judgment. For example, suppliers might suggest an option for salespeople to purchase the laptops themselves at a reduced cost. This option would solve problems during employee turnover-exiting employees would own their laptops and new

employees would purchase a laptop through the program. An internal expert might then suggest that employees receive a technology bonus to help offset what they might view as an added expense.

Expert Judgment, both internal and external, is an asset in making many procurement decisions. Types of Contracts $\$80\text{th} = \$12,000 + \$40\text{th}$
Subtracting $\$40\text{th}$ from both sides, you get: $\$40\text{th} = \$12,000$ Contract type is an important consideration. Different types of contracts can be used in different situations. Three broad categories of contracts are fixed price or lump sum, cost reimbursable, and time and material. A single contract can actually include all three of these categories, if it makes sense for that particular procurement. For example, you could have a contract with a seller that includes purchasing specific reward for a fixed price or lump sum, some services that are provided on a cost basis.

Project managers and their teams must understand and decide which approaches to use to meet their particular project needs. It is also important to understand when and how you can take advantage of unit pricing in contracts. Fixed-price or lump-sum contracts involve a fixed total price for a well-defined product or service. The buyer incurs little risk in this situation since the price is predetermined. The sellers often pad their estimate somewhat to reduce their risk, realizing their price must still be competitive. For example, a company could award a fixed-price contract to purchase 100 laser printers with a certain print resolution and print speed to be delivered to one location within two months.