

Centralized Purchasing: Advantages and Disadvantages



As a business grows, centralized purchasing becomes more important. With a decentralized purchasing structure where individual departments are responsible for their own purchasing, businesses often end up paying more as a result of their inefficient processes.

Centralized organizations, on the other hand, operate with a more efficient purchasing process by dedicating their own department, otherwise known as a procurement department.

In some instances, a small business only needs a purchasing or procurement manager rather than an entire department with multiple staff members.

Degrees of Centralization

Centralized purchasing may refer to an entirely centralized organization or a center-led organization structure.

The purchasing department develops purchasing policies as well as standard operating procedures for the entire business.

With an entirely centralized structure, the purchasing department handles all purchasing duties in activities for every department or division from a home office or headquarters.

With a center-led structure, the purchasing department develops purchasing policies and standard operating procedures but allows each department or division to maintain their daily purchasing duties and responsibilities.

For many organizations, a centralized purchasing department makes the most sense.

Centralized Purchasing Advantages

Better Strategic Efficiency

Your long-term business goals and purchasing department injective are often linked directly to your centralized purchasing structure.

The primary reason for this is that many companies consider procurement more important within a centralized purchasing structure.

When a business perceives greater importance on centralized purchasing, it improves visibility within the organization and makes means they're more likely to participate in long-term strategic planning.

By building procurement initiatives into your long-term goals, your business's financial success automatically links to your procurement goals.

More Procedural Efficiency

Moving towards centralization eliminates duplicated and redundant efforts.

By sharing information and resources, there are opportunities to combine departmental purchases so that you can qualify for volume discounts and also reduce your delivery and transportation costs.

You'll be able to streamline the process with automation, across different departments if you handle everything from a central location.

A centralized procurement model also makes it easier to create and maintain strong relationships with your vendors and suppliers.

How? One way is that it reduces confusion among your suppliers who no longer have to wonder about who to speak with regarding each purchase order.

With a decentralized approach, your employees are empowered with a budget and the initiative they need to determine what they think is useful and can buy right away up to a certain limit of course.

Whether it's physical supplies or software subscriptions, your employees can make expenses without needing to sign any kind of Link the contract.

Because most purchases made this way are one-off and not made under contract, decentralized purchasing is generally purely transactional.

Your employees make their purchases without building any kind of long-term relationship with vendors even if they'd love to do so.

It's not possible because the volume of business each employee or department brings to the vendor is not worth the time and effort for the supplier to build better relationships.

When you look across the entire organization, however, it's easy to see that you're spending substantial amounts of money on requiring supplies.

However, it's impossible to tie that to a beneficial vendor relationship or use it to negotiate volume discounts.

When you implement a centralized purchasing model, however, everything comes to a single location which allows your purchasing department to leverage your volume with suppliers to foster has long-term relationships that help you save time and money in the future.

Improved Control and Management

By centralizing your purchasing policies, you'll have greater internal control. You're purchasing policy allows for top-down information flow which standardizes decision-making and purchasing activities.

For instance, a centralized policy clearly outlines the employees who are authorized to create a purchase order along with outlining the criteria for choosing vendors and specific spending limits.

Everyone else has to rely on purchase requisitions, which are only converted to an official order upon approval.

Relying on a centralized procurement organization structure can also help you address ethical issues.

For example, it clearly outlines your business's position on accepting gifts from suppliers, helps identify instances that may constitute a conflict of interest, and specifies the company's position on maintaining confidentiality.

With that improved control and management, organizations often find cost savings in multiple areas.

Not only will they find that they have reduced overhead expenses, but the improved purchasing power will qualify them for volume discounts to help save money. The savings can then be transferred to other areas of the business to help it grow.

Purchasing isn't always a clear-cut venture.

There are generally other responsibilities that come up alongside purchasing supplies, for instance making sure that the vendors supply quality products, minimizing vendor risk, and signing contracts with suppliers.

If there's ever a situation where employees across your organization are making these purchasing decisions and commitments, you've definitely got a problem on your hands.

With centralized purchasing, you address many micro-purchases and combine them across the organization. This reduces your overhead costs associated with inventory management, quality monitoring, risk analysis, and transportation.

Using a centralized purchasing approach, your purchasing department combines identical orders and pushes them toward the vendors that can offer them the best deals.

This leads to even better pricing because the volume of business to purchase department can offer is stronger.

As such, the vendor is more willing to offer volume discounts to secure your business for the future.

You'll also be able to eliminate maverick spending which occurs when employees make purchases outside of existing contracts that you've established with vendors.

This only happens within companies that run with a decentralized purchasing model because there's no easy way to track all of the contracts the organization has with suppliers.

What commonly occurs is that employees purchase from the most convenient suppliers they can reach regardless of whether there's a contract or not.

Contracts that don't perform well may attract penalties for your organization because you don't keep your end of the bargain in terms of minimum order figures.

Using a centralized approach eliminates the risk of employees going outside of the existing procurement process to prevent maverick spending before it can occur in the first place.

Centralized Purchasing Disadvantages

Standard Procedure May Cause Receiving Delay

The early stages of developing policy and procedures may cause delays in receiving items that are needed.

Even after these policies have been established, the time it takes to follow the standard procedure may also lead to receiving delays.

Wrong Buying is Possible

In some situations, specific requirements of individual items may not be addressed successfully.

In certain situations, it may mean that there is a mismatch between the people who need the item and the people who are buying it.

When this happens, the procurement department may purchase items that the requesters cannot use because they don't meet their needs.

Procurement Expertise May Not Be Matched to Company Needs

With a centralized buying department, there's always the possibility that the purchase purchasing staff may not be experts and buying all of the varied types of items the company needs to run smoothly.

In this case, the document staff may not be buying the items and services the company needs to be successful.

May Adversely Impact Employee Morale

Empowering employees with The ability to buy what they need when they need it as long as it falls within a certain dollar amount threshold, helps to boost morale.

If they lose the ability to make individual decisions about their own purchases in accordance with centralized policies, they may become frustrated by the fact that they have to rely on someone else to secure the things they need to effectively do their jobs.

Where Centralized Purchasing May Not Make Sense

A centralized purchasing process does have many advantages for companies, there are some situations where it isn't the most effective choice.

If each business unit or location has unique needs, centralizing everything in a single procurement department won't help you reap any benefit.

If your business has:

- Limited to no overlap between suppliers

- Has a different concentration of purchase types - for example, one business unit spends more on services rather than materials
- Each business unit has its own profit and loss, making consolidation difficult

Then keeping a decentralized purchasing model in place is the right way to go.

The key to an effective centralized purchasing strategy lies in the expertise of your procurement staff and the effectiveness of your purchasing manual.

Your purchasing manual is the document that outlines policies and procedures that need to be followed by the people purchase making the purchases.

It contains all of your approved statements of policies and will answer any recurring questions.

Producing the purchasing manual may become a source of conflict because many purchasing managers find it to be restrictive.

As you build the manual and develop the processes, you can eliminate much of the potential for conflict by:

- Clearly defining the purchasing authorities
- Clarifying the relationship with other departments
- Seeking cooperation from team members and stakeholders while preparing the policies and the purchasing manual
- Keeping these policies and procedures separate from those that are of a permanent nature. As the business grows and evolves, certain procurement procedures will change frequently. For example, when new or better vendors come along with contracts that are more friendly for your business and others, you may need to change the manual to update the list of vendors you want people to use.

Your purchasing manual is one of the most important tools for managing your organization's purchase function efficiently. Even if you are a small organization that lacks a complex purchase function, the purchasing manual can still help you.

If you rely on one person to make all of the purchases for your company, and that person is out sick or quits the job, you run the risk of completely paralyzing your purchase activity.

With the purchasing manual, however, it becomes easy for someone else to step in and take over the job reducing the risk of becoming dependent on a single employee.

Ideally, your purchasing department should consist of employees with experience related to the products and services your business requires to run.

Procurement expertise in and of itself is of course helpful, but if it is not related to your industry, you may find wrong buying to be a more frequent occurrence.

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