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PROCUREMENT BY INDUSTRY

8 December 1948

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Publication No. L49-59

THE INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

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GENERAL HOLMAN: How does industry do its job? That is the question you will frequently ask yourselves in dealing with many of the problems involving economic mobilization. We have studied procurement in the military departments and in the nonmilitary governmental agencies. Today, we are going to learn about procurement in industry.

Our speaker brings to this platform a wealth of experience in both military and nonmilitary procurement. During the war he was the civilian chief of procurement for the United States Navy. Since the war he has been the Director of Materials for the Radio Corporation of America, RCA Victor Division.

It is a pleasure and a privilege to introduce to you and to welcome to this platform, Mr. Vincent dePaul Goubeau.

MR. GOUBEAU: Thank you, sir. General Vanaman, Colonel McKenzie, gentlemen: It is a pleasure to meet with this interesting gathering and to discuss procurement problems with you. I would like to give you a general picture of the procurement function in industry and also indicate some respects in which the commercial operation may be related to that of the military. I'll separate this discussion into two parts--organization in the first category, and policies, procedures and practices will take up the second category.

ORGANIZATION. Any discussion of organization usually introduces the question of centralization versus decentralization. That is the modern question in business today. In reviewing that subject it is interesting to note that shortly after the closing of the last war, when the materials situation was so tight as to interfere seriously with production, the producer who was centralized contemplated the advisability of changing over to a decentralized operation and vice versa. People frequently feel that when they have trouble their trouble stems from weakness in organization. It took some time for industry to realize that there was not necessarily anything wrong with the fundamental operation of its companies, but that we were experiencing an economic situation which prevented an orderly conduct of business. In addition, as a result of war experience and as a result of ambitious plans for the future, everyone expected individually to be able to produce everything the country could use without regard to that company's ability to meet such production requirements. Some people discussed with me the advisability of changing from a centralized to a decentralized

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operation, while at the same time other people were talking about giving up a decentralized function in favor of a centralized one. The answer, of course, was not to change organization merely for the sake of change because one was having problems, but, rather, to systematically and scientifically analyze one's business to determine its needs.

Generally speaking, there are three or four types of purchasing organizations: First, complete centralization whereby one purchasing unit does all the buying for the company's operation. This type of organization is common with the average-size manufacturer who has one plant or multiple plants usually manufacturing similar articles. This has been a very common type of operation, and with the exception of the purchase of maintenance items at plant level all buying is done at central headquarters. This operation is usually most satisfactory from the purchasing agent's point of view in that he can purchase to the best interest of the company insofar as utilization of its purchasing power is concerned. Centralized procurement is also usually the most economical. However, unless planning and scheduling are satisfactorily geared to the purchasing function there may not be sufficient flexibility present to justify a completely centralized unit.

A second type of purchasing organization is a variation of the first method whereby common items will be purchased centrally, but items peculiar to a particular plant will be purchased by the resident buying group at that plant. That introduces a combination centralized and decentralized purchasing.

The third type would be complete decentralization by product line or division, same as General Motors, General Electric, Westinghouse Electric, and my own company--the Radio Corporation of America. Bethlehem Steel, U. S. Rubber, DuPont and other large companies follow the second type of organization whereby most of the production buying is done at central headquarters with supplementary buying being performed at plant level of items peculiar to that plant.

There is a fourth type function, perhaps more common in the merchandise field, that of buying in geographical areas adjacent to principal markets of individual items. For example, you might buy fish or woollens in Boston, textiles and clothing in New York, furniture in Chicago, and lumber in the South. Unless, however, there is very substantial volume justifying the setting up of adequate offices in the areas of the markets themselves, this operation would not lend itself to most efficient buying methods of a manufacturer. I had a discussion with an official of a very large producer who followed this practice. He had upwards of twenty-five plants located in various sections of the country, manufacturing the same or similar product. These people made an investigation of their procurement functions and

they found that what they had were resident buyers located in various sections of the country with almost a complete absence of central control. Proper supervision was entirely absent. They changed their setup in favor of pretty much of a centralized buying function with some resident buyers located at various points but reporting to the director of purchases at the home office.

The determination of centralization versus decentralization should be made on the basis of the conditions of an individual company's operation, including the type and variety of products manufactured, the importance of close alignment with planning and material control functions, and the volume of kindred items used in manufacture. These and other conditions should be thoroughly weighed. It seems to me that if sufficiently large volume of all important items is present in each division of a company, the advantages of decentralization far outweigh the disadvantages. Such matters as purchase policy, reciprocity, vendor relationships, and broad, general control of purchases can be handled at a policy level by a staff function.

The outstanding disadvantage of centralized buying, of course, lies in its lack of flexibility. Life is more complex these days than in the past, thus introducing the need for freedom of action and delegation of authority. Centralization also, if carried to the extreme, can limit the opportunity for acquiring knowledge of conditions in various locations and may restrict progress. However, the question of economy is presented in connection with decentralized purchasing operations and here, again, a sound approach is necessary, as otherwise too much duplicate organization may develop.

As you probably know, our corporation is made up of various divisions such as the National Broadcasting Company, RCA Communications, RCA Laboratories located at Princeton, New Jersey, RCA Institute, Radiomarine Corporation of America, and our own RCA Victor Division. The Radiomarine Corporation and Victor Division represent the two enterprises engaged in manufacturing such as any industrial corporation; the other branches of the corporation represent different types of business. For the purpose of this discussion I will confine my comments to the RCA Victor Division, which is the principal manufacturing arm of the corporation.

The RCA Victor Division is made up of several separate divisions or departments which function on an individually independent basis but with coordination and close relationship to make up for a unified and consistent organization, policy-wise. We have four principal product departments: Engineering Products Department, Records, Tubes, and Home Instruments. Each of these product departments is headed by a vice president of the corporation who acts as general manager of his

department. All the functions of his business report to him, including Sales, Engineering, Purchasing, Manufacturing, etc. The various functions in each department are sufficient unto themselves but are coordinated by staff functions such as Finance, Accounting, Law, Purchasing, and so on.

The thinking in back of a setup of this type of organization was that in order for the product departments to be held responsible for their operation, including profit or loss, it would be necessary to include in their structure all the functions pertaining to that business so that that responsibility would mean something.

As you will note from this description, we have a decentralized operation, product department-wise, although not necessarily geographically. Three of the four product departments make their headquarters at Camden, New Jersey; the fourth, the Tube Department, is located at Harrison, New Jersey, which is also the location of our principal receiving tube plant. Supplementing manufacturing facilities in Camden and Harrison, New Jersey, we also have plants in numerous other cities: Lancaster and Canonsburg, Pennsylvania; Indianapolis, Bloomington and Monticello, Indiana; and Pulaski, Virginia. The operation of each plant is supervised by a plant manager, but he reports to the central headquarters which, as mentioned, is either at Camden or Harrison, New Jersey.

I give you this organizational background so that you will understand how our purchasing function is carried out. Each product department has a purchasing organization headed by a purchasing agent located at headquarters. All production buying, that is, the purchase of materials and components used in the manufacture of a product, is made by the home purchasing unit in each product department; the only purchasing performed at outlying plants would be items of a maintenance nature where it is found logical to purchase locally. This type of organization combines centralization and decentralization, permits of proper flexibility and a close tie-in with plans and schedules, while at the same time permits of concentration of purchases to the degree of satisfying ourselves that we are obtaining the benefit of our volume purchasing power.

Coordinating these individual purchasing units is a General Purchasing Division, also located at Camden, New Jersey, which sets up policies and procedures for the product departments to follow. In addition, the General Purchasing Division places contracts for common items which all the product departments draw against. This, again, is done to warrant our obtaining the best prices and best service through the concentration of volume. This central contracting process has another advantage. The department which purchases smaller quantities is in a position to receive equally good service as the volume buyer by virtue of an over-all centralized contract.

Another function of the General Purchasing Division is to allocate our purchases of items common to more than one department among qualified producers where specific contracts may not be feasible--take, for example, capacitors, or resistors, or other electrical components. Types, kinds, and specifications vary within a product department as well as between product departments to such a degree that an over-all stipulated contract, including prices, etc., would be burdensome. It then becomes logical to concentrate our purchases by all product departments among the qualified producers and percentage-wise allocate the business to them. Without that sort of action we might find ourselves doing business with hundreds of people. Scientific purchasing then disappears and the procurement function gets out of control.

Another feature of the activity of the General Purchasing Division involves the setting up of price lists, covering maintenance items for all plants to use if advantageous. In other words, if the common, ordinary maintenance items like plumbing supplies, hardware, etc., can be purchased locally by each plant at as attractive prices as the price list set up in Camden, then it is logical to purchase locally. The resident buyer at each plant through this means has a comparative figure to use so that the local area can either be competitive or he can draw from Camden's source of supply. So, we have three separate functions definitely related to actual purchasing which are performed by the General Purchasing Division: (1) central contracting for all operations to draw against, (2) allocation of our business among qualified suppliers, which allocation will be followed by all product departments, and (3) the setting up of price guides for maintenance items for all plants so as to develop the competitive picture while permitting flexibility in the obtaining of the items needed.

In addition to these actual functions of the General Purchasing Division which I have mentioned, we are responsible for the developing of policies and procedures which the purchasing groups in all product departments will follow.

Our purchasing organization parallels to a considerable degree the organizational setup of the Navy Department. For example, the Bureau of Ordnance procures guns and ammunition; BuShips--ships and components; and BuAer--planes and accessories. Our product departments specialize similarly; our Home Instrument Department produces radio and television receivers which the consumers use, Engineering Products Department manufactures transmitters and all types of special apparatus, and our Tube Department produces tubes which are sold to the entire electronics industry. These product departments procure for their own use the materials and components they require.

Returning to the Navy organization, we find that coordinating the activities of these bureaus, the Secretary's Office has a procurement branch in its Materials Division which sets out policies and procedures which the bureaus will follow in their procurement function. The Bureau of Supplies and Accounts places contracts for common items, Our General Purchasing Division combines some of the functions of both the Materials Division of the Secretary's Office as well as the Bureau of Supplies and Accounts.

This brief description I am sure will show you, at least in a general way, how the procurement function of my organization in a way duplicates the decentralized procurement operation in the Navy Department. I will be glad to discuss with you later the procurement organizations in the Army and Air Force although I may not be up to date with respect to their buying organizations. I assume the larger portion of the Air Force procuring is performed at Wright Field, while the technical services of the Army procure individually at various locations.

POLICY. A good many companies have made it a practice to compile and distribute a manual of purchasing policies. The policies contained in our manual are similar to those of a good many other companies. I have reviewed the manuals of Gulf Oil, Detroit-Edison, Aluminum Company, Bigelow-Sanford Carpet Company, and one or two others; I find a great deal of similarity. These policies include such broad subjects as ethics, procurement from reliable sources of supply, selecting a limited number of qualified sources in each industry, and establishing long-term relationships with them. The manual also includes statements concerning contacts not only with vendors but also with different functions within the company. These and numerous others are the general type of statement common to the purchasing function. I will be glad to discuss these in detail later if you are interested. I have selected a few for specific description.

Purchasing by Purchasing People.--One of these states that the purchasing functions shall initiate, conduct and conclude all negotiations for the purchase of materials, equipment and supplies necessary to the conduct of the company's business in conformance with RCA Victor Division policies and procedures as well as government laws and regulations. In other words, the purchasing function shall be performed by the qualified, specialized people designated for that purpose and not by technical, sales, financial or other personnel engaged primarily in other activities. We have found by experience that through placing definite responsibility we can be assured of progress towards the ultimate objective of lowest costs, adequate service, and satisfactory relations with qualified suppliers. Confusion and entanglements often result from contacts with vendors by representatives of other departments. We, therefore, take a very definite position in this respect. On the other hand, I call attention to the fact that our policies also require

constant contact with other functions in the company to be assured of a unified approach. For example, a new producer's product must be approved by our Engineering Department before purchase can be made. We accordingly urge and encourage close contact between departments while placing the purchasing responsibility where it belongs.

Selecting Sources of Supply.--A second outstanding policy is to avoid wherever possible the use of single sources of supply. Labor unrest and scarcity of materials since VJ-day have brought home to industry the importance of following that sound principle. By the same token, it is also the policy not to have more sources of supply for a commodity than necessary to insure a continuing supply and a competitive position. The further we stretch our business the thinner it becomes and the less opportunity there is to use our purchasing power to best advantage. Further than that, the most important feature of good procurement is to develop reliability and loyalty among our sources of supply because they are a very important link in our manufacturing processes. If our business is spread so thin that loyalty and keen interest are not present, we cannot purchase most efficiently and guarantee support to our production lines.

Open Bidding Versus Negotiation.--To accomplish the objective in connection with selecting sources of supply, we have a policy covering the obtaining of bids as they are the tools for reaching that objective. The purchase of equipment and supplies for maintenance purposes is usually accomplished through the medium of obtaining competitive bids and awarding the business to the lowest bidder, provided such bids meets the required specifications. In buying for production, however, the objective should be the placing of business with regularly established sources of supply so selected rather than searching the market at frequent intervals. There are means of checking prices to determine that our supplier is competitive without continually hopping from one source of supply to another. That is a tragic procedure for a manufacturing operation. Some companies still practice it. They are usually less efficient in their over-all operation than are those that, might I say, marry their sources of supply. If we select two or three sources of supply to furnish a given item we develop sufficient competition and yet can allocate our business percentage-wise among them so that we will have a mortgage on their production line and they will like our business because it is reasonably constant. It seems to me the military representatives should, and I am sure do so, use the same approach in connection with their procurement, at least to the degree that they are able to do so. The loyalty of a supplier and the continual use of his assembly lines make for sound policy whether the purchase be for a part or for a finished gun, ship, or plane.

I realize that private business has much more freedom and flexibility in its dealings with suppliers than might be the case in Government. If our procurement people are satisfied that a certain company is not a good source of supply, his know-how, manufacturing efficiency, engineering ability, or other qualifications are limited, decision is made that we will not do business with such company and we are under no obligation to do so, whereas in procurement by Government the taxpayer's dollar is immediately introduced and everyone feels he has a right to sell the Government. Where those conditions prevail I suppose the natural reaction is to use formal competitive bidding. We found in our analysis of procurement when some of us businessmen first entered the Services in the early part of the war that the formalized competitive bid system discouraged many qualified producers from selling the Government if they had the privilege of selling their output in the commercial market, which is the case in peacetime, and the limited producers or jobbers were very often the only ones who would submit bids on government contracts for commercial items such as textiles, clothing, paper, and similar products. The passage of Public Law 413 was a great forward step in my opinion in that it introduced, at least to some degree, the opportunity for purchasing by negotiation, although I realize that the Law does not permit of complete elimination of the competitive bid system nor should it.

Utilization of Small Plants.--In connection with this subject I might mention the question of utilization of small plants. All during the war we had before us the problem of the Smaller War Plants Corporation. Maury Maverick was ever watchful to see that the Services were giving the smaller producer his full share of business. I am sure from what I have heard that the small plant problem is still with you. In private business we do not have to worry about the distinction of small or large business. Our measure of qualification is that a supplier render sufficiently satisfactory service to warrant our receiving materials at the right time, in the right quality, and at the right price. We do a very substantial amount of business with small concerns, which is a common practice in the electronics industry. Usually when we introduce a new source of supply we have a survey made of its plant, the same as probably the Services do through the use of their inspection personnel. In addition to analyzing new source facilities we look into their position with raw material sources. That, of course, is very important today with materials, principally metals, being in such tight supply. If a fabricator does not have a satisfactory steel resource, one has to decide whether to supply the raw material to him or find another source. We, therefore, look at his procurement picture because, like ourselves, he will be only as good as his suppliers,

His financial position should also be reviewed. If he is weak financially, there must be some reason for it unless he has been in business only a short time. If he is faced with bankruptcy, his

production will suffer; then we will not receive proper support. We try to avoid financially weak companies in our procurement operation. In this connection, it has been my experience over a large number of years that somehow or other financial stability seems to go hand in hand with qualified productive ability. An enthusiastic engineer or junior buyer sometimes becomes hot and bothered about a supplier who seems to know how to do everything but whose financial position somehow or other is very weak. Usually, if the procurement man decides to do business with him, before too long he will find that the component he has purchased will be rejected because of poor workmanship. You recall the old expression, "if you are so smart, why ain't you rich"; somehow or other it seems to follow that the smart producer seems to be able to earn enough profit to keep a sound financial position. That, of course, is not always true and on occasion we see the possibilities of a good source of supply, though limited, and encourage him to the point at least of our being able to determine whether he is a good investment for the future. I think we should buy sources of supply the same as we buy people. It is an investment.

A bad practice which we have to watch carefully with inexperienced buyers is the tendency towards overloading a small producer even though qualified. It may be satisfactory to place fifty thousand dollars worth of business with a small company over the course of a year, but it would be foolhardy to give him a million dollars worth of business because he is not set up to handle such a large volume. A fellow may be awfully good to produce a thousand transformers a month, but he will fall on his face if you ask him to give you a hundred thousand a month.

There is a place for the small producer and there is a place for the large one. When the little fellow becomes so ambitious that he thinks he can build a battleship he is over his head. The result is that one yard goes into bankruptcy and one Navy is without a battleship.

PRACTICES.--Cost Analysis.--One question which very often is asked at purchasing forums runs something like this: When several sources of supply are available for a given item, the procedure to follow is usually a reasonably simple matter. The obtaining of competitive bids, evaluating the bids and determining the most desirable bidder, which frequently is not the lowest in price, is reasonably clear and experienced purchasing men are performing that function all the time. But how about the handling of a purchase from a single source of supply? How do you determine the reasonableness of the price? Numerous answers can be given, one outstanding one being the matter of cost analysis. We endeavor in our company to set up a standard cost, particularly on items of repetitive purchase where considerable volume is involved. For example, we know how much it costs us to produce a radio or television receiver because we have established standard costs for each of

the important items of purchase which go to make up that receiving set. We have a group of estimating people who analyze the item by determining the raw material to be used and its cost, the type of machines necessary to fabricate it, and estimate the cost of operation for those machines and then the labor and overhead. To that we add the usual administrative and profit figures and come up with a pretty realistic estimate of what the part should cost. That information is passed to the buyer for his guidance in negotiating a price for the article to be procured; or that information may be utilized for price comparison. Occasionally we experience wide discrepancy. Our buyer calls in the estimating engineer they sit down with the supplier and after sufficient discussion we find the price ends up somewhere in the area of our estimate. We don't do that with the idea of reducing profit. As a matter of fact we figure about 20 percent in our estimate for the supplier. Our negotiation includes discussion of methods and processes and very often the supplier might get a tip-off as to a better method for making a part. (Rocker Arm Assembly for auto set.) This is one method of analyzing the cost which we should pay for an item. Naturally you cannot do that with every purchase; unless there is a substantial volume involved, the supplier will not agree to sit down with you and negotiate in this fashion. So, my answer in purchasing forums as to how to handle the procurement from a single source of supply is to make up your own mind through proper analysis by qualified technical people plus material costs, which the purchasing people can furnish, what an item should cost you. This represents tremendous ammunition for buying the product at the right price and being satisfied that it is a reasonable price and which will also reflect a reasonable profit to the producer. One cannot stay in business by taking business at a loss; that means that we would lose a good supplier. We don't want to buy products which are sold to us at a loss because the situation could only be temporary. Anything which is wrong fundamentally must be wrong in fact.

The military have a great advantage in this area of negotiation. You can obtain cost information from your source of supply, which is very difficult to obtain in commercial life. We ask for cost breakdowns from our suppliers on government purchases. Occasionally the supplier will give us a cost breakdown; other times the supplier will tell us he will furnish it to the Government, but not to us. One manufacturer does not wish to divulge costs to another as a regular practice. Several of us who were in the Services during the war introduced new methods in connection with the obtaining of cost breakdowns and I recall Mr. Folsom mentioning to me early in 1942 that this method of procurement will be utilized in the Services after you and I are back home in private business. That was indeed a real prophecy. I think the ideal procurement team would include a negotiator, a price analyst which might be an experienced financial analyst, and third, an estimating engineer. One cannot beat that type of a team.

Limitation of Buying Authority.--Another point which might be of interest to you is the question of limitation of buying authority. Such an instruction is included in our manual. Our procedure requires the approval by the General Purchasing Division of all large dollar-volume orders or contracts prior to award. This procedure duplicates the Contract Clearance function in the Navy Department whereby certain contracts have to be approved by the Materials Division of the Secretary's Office. The requirements in the Navy, I understand, are somewhat different now from what they were during the war, but at that time all contracts over \$200,000 had to be cleared by the Contract Clearance Office, while the War Department only required clearance of contracts totaling five million dollars. I assume that this procedure is still in effect which requires the approval of the Office of the Under Secretary for both the Army and the Air Force. The disparity between the clearance value in the Army and the Navy stemmed, I think, to a degree from the fact that procurement in the Army was so decentralized geographically that considerable delay may have been experienced if it had been necessary to submit to Washington contracts of smaller value; on the other hand, the majority of Navy contracts were made in Washington, although by the different bureaus, and, consequently, the clearance function could be performed in a matter of days, hours, and, in some cases, minutes, depending upon the emergency nature of the proposed procurement.

Now with regard to RCA, as I stated, the General Purchasing Division conducts a contract clearance function, so to speak, similar to that of the Services. Naturally, the value is considerably lower as we do not issue many contracts amounting to millions of dollars.

In the product departments, our regular buyers may place orders up to the value of five thousand dollars while an assistant buyer is limited in purchases up to one thousand dollars. Purchases exceeding five thousand dollars have to be approved by the product department purchasing agents.

We find that limitation of buying authority to be a very sound procedure. It permits of wise counsel, and sometimes second guessing is a very desirable activity if held within bounds. In some companies procurements exceeding a certain dollar value require approval by the board of directors. We do not have such a ruling, except in the case of expenditures for capital assets such as buildings, equipment, etc. Such plans have to be approved by the board of directors and appropriations are set up following such approval. Other than capital asset procurements, purchases for the most part in manufacturing operations involve the obtaining of our needs for production lines, which production will be based on sales plans. Procurement is restricted or extended, depending upon market conditions, including price and availability. Availability is usually the governing factor because it is our

policy not to gamble on markets in anticipation of price increases. Many a manufacturer has gone out of business because of too heavy an inventory position.

Volume Procurement.--A desirable practice in connection with the handling of large procurement which was successfully used in the early days of buying for national defense and also during the war was that of negotiating with individual producers for portions of the requirement instead of publicizing the entire needs. This practice avoids the upsetting of markets. For example, if you are in the market for ten million pairs of shoes it would be most upsetting to the market, particularly in peacetime, if you were to send out formal requests to numerous shoe manufacturers informing them that you are in the market for ten million pairs of shoes and asking them what portion of it they could furnish. It is much more desirable to bring in shoe manufacturers individually and ascertain from them their current position of manufacture and negotiate with them covering whatever portion of your requirement they are in a position to take, whether it be ten, fifty, or one hundred thousand pairs. You will find that you will have placed a good portion of the procurement before there has developed sufficient reaction in the market to cause increased prices. Another practice which goes hand in hand with this one is the purchasing of commercial needs during off season. The merchandise business, particularly the mail-order houses, over the years have made desirable contracts with manufacturers to take their output in the off seasons. This was of particular advantage to the manufacturer because it permitted him to continue his production on somewhat of an even keel and spread out his overhead. Increased production was possible and attractive prices resulted. Since VJ-day almost all lines have been pretty much occupied until at least recently, and that type of scientific buying was more difficult except in those cases where it has been a continual process for a long time. I recall a contract which a mail-order house had with a manufacturer of sheets and pillow cases. Arrangement was made with a manufacturer whereby he had a standing order which he could start in production whenever his regular business suffered; in other words, whenever his current orders were completed he would keep his production up with the particular contract for the mail-order house. Needless to say, the mail-order house received a very attractive price. To what degree the Robinson-Patman Bill may interfere with that process I do not know, but it is very wise buying.

Vendor and Intracompany Relations.--Finally, I would like to repeat my earlier statement that there is no substitute for a qualified, loyal supplier and procurement should be performed, certainly in industrial life, and I think in Government too, with the thought in mind that the lowest one-shot price may not be to one's best interest over the long pull. One can win a battle but lose the war. One of the outstanding policies of our company is that of developing good vendor

relations. One can be eminently successful if he has the proper resources backing him up.

Equally, good intracompany relations are most important to a successful procurement function. If the chief engineer, plant manager, and purchasing agent can all see eye to eye, flexibility and freedom of action will permit of the most successful procurement practices which ingenuity and science can produce. If, on the other hand, jealousy, petty bickerings, and personal empire building are the common practice, the company is severely handicapped and science is replaced by narrow personal ambition.

Industry is finding out more and more that one of the most important qualifications of an executive, whether he be junior or senior, is the ability to get along with people. Without that qualification, progress is impossible.

Thank you very much, gentlemen.

QUESTION: In some other meetings we have a great deal of discussion as to just what constitutes a central procurement system. One of the previous speakers stated that if a company had centralized control, he considered it a centralized system, even though that central agency did not actually procure anything.

Would you comment on that, please?

MR. GOUBEAU: I would say that it is all according to your point of view. I don't know how you can call an operation centralized if it, in effect, is not centralized. Central control is one thing and central operation, in my opinion, is another.

I think probably the speaker may have intended to convey the thought that you accomplish the same objective if you have a centralized control, where you sit on top of the procurement--take, for instance, Dupont and U. S. Rubber. Dupont buys a great deal in Wilmington, but it also does some buying at the outlying plants. But Tom Harris, the director of purchases, determines whether that plant will buy a certain item or whether he will buy it in Wilmington. Stan MacKenzie does the same thing at U. S. Rubber, in New York. He sits on top of it and he has control. The purchasing agents at the outlying plants report to the plant manager and they do their own buying, subject to the central control of the home office.

That is different, for example, from what Ford had before the war. Believe it or not, he did not allow any procurement exceeding \$50, outside of the home office, anywhere in the United States. It was all done right there. That is what I call "complete centralized procurement."

But the centralized control would mean that the central operation sits on top of it while the actual function may be performed at the plant. There are a lot of desirable features about that because at the plant level they can work their schedule of delivery closer with the supplier if they are on the home ground.

QUESTION: I believe you indicated, sir, that the ideal service procurement team included a price analyst. I would like to know how the services of that individual would vary in time of peace and in time of war.

MR. GOUBEAU: With the present structure in the Services, as I understand it, I don't see much variance between the price analyst now and a price analyst during the war. You are doing a great deal of buying through cost analysis now. I know in the War Department during the war there was a negotiator and a price analyst, working as a team; I assume that is a continuing practice.

Where you are buying through negotiation on a cost-analysis basis, in peacetime I don't see any difference at all. I think it is very desirable because, if it be carried out in that way, should we have a war all you would have to do is augment the staff. You already have the procedure.

QUESTION: Would you care to express your feelings with regard to excess-profit taxes being substituted for renegotiation in government contracts?

MR. GOUBEAU: Let me see which hat I am going to wear now. To be on the safe side, maybe I had better get out my old Navy hat. Let me tell it in three steps:

We sat down with the suppliers during the war and negotiated contracts. We would ask them why they had to have 30 percent contingency in their price, and so on. They said, "Why do you fellows worry about that? You're going to get it all back in renegotiation." We pointed out to them, "If we allow you a great big cushion in your price, you are going to go out and you are going to hire two men instead of one man because you are going to say, 'They're going to take it back from me, anyway!'"

There was no incentive to hold down costs and to improve production because as you up production you lower costs. Consequently, we had to drive that thought home: The closer you can buy in the beginning the more efficiency you encourage in the supplier, particularly where you need all-out production.

I am sorry to say that until our procurement function was refined some of our contracting officers said the same thing, "What are you bothered about? Forget that stuff. Let the Price Adjustment Board do it." The minute you do that, you automatically let down the bars and the Price Adjustment Board takes away what is left. I don't want to say this specifically but, in effect, you could have a cost-plus-a-percentage-of-cost situation.

If you did not buy properly in the original procurement, you would avoid the incentive. If you did not have renegotiation you also would not have the opportunity of sitting down with the supplier and evaluating with him his efficiency. That was one of the outstanding qualifications in renegotiation. So everything would go into a pot and everybody then got what was left. He doubled his price so that he could end up with the same profit he wanted in the first place.

For that reason, I think that it is fundamentally right to, first of all, try to do your procurement right. Don't take all of his profit away from him. If you have renegotiation, evaluate the job he has done and let the Internal Revenue Department take care of the poor fellow after he is through with that.

QUESTION: How about putting on the other hat now?

MR. GOUBEAU: I am, essentially, a procurement man--well, let me take my hair down.

We, in RCA, would prefer to do business on the basis of standing on our procurements and meeting up with any government regulations, separate, apart from, and preferable to relying on the tax feature because we find that is not sound. And if it isn't sound, I don't think my office will gain anything. And, incidentally, I might mention that we in RCA, individually, as well as John Q. Public, are all taxpayers.

If the volume of purchases to be handled by the Armed Services reaches large figures which would represent a good percentage of the total production of any industry, I would recommend renegotiation as a good safeguard. On the other hand, if the volume of procurement does not reach substantial volume, I do not believe renegotiation would be necessary. The thing to bear in mind is that in renegotiation there may be more opportunity afforded to evaluate the efficiency of a producer; whereas through the medium of excess-profit taxes everything beyond a certain figure is drained off, thus discouraging initiative.

QUESTION: I have two questions on cost analysis. What do you do when you negotiate for an article which has not been made previously? In other words, how do your cost-estimators get hold of an article on which there is no previous knowledge?

The second question is, How do you calculate your profit? Is that on the cost of an individual item, on the overhead, or what? I mean the type of capital that is employed? Is it on turnover?

MR. GOUBEAU: With regard to the first question: In private business, we don't use, and can't use, the same "ammunition," I might say, that the Services can use or the Government can use. So consequently, in private business when we are doing business with somebody for the manufacture of something that has never been made before, we will take a broad view of it and either agree that we will review costs with him or rely on his coming to us after he has had experience and discuss the cost.

On the other hand, if we are satisfied that he knows pretty well what it will cost to manufacture this thing, even though he hasn't made it before, we will accept a firm price from him and, as they say, "the devil take the hindmost."

After all, we do expect to lose something. There has to be a certain amount of gamble in it. That plays a very important part--in other words, your confidence in your supplier. If you haven't done business with him before, you are not going to give him a blank check.

The second question was what?

QUESTION: You allow so much profit. How do you calculate that?

MR. GOUBEAU: You understand that this estimate of cost is a guide and not something that has to be followed or has to be met. Consequently, you have variations in the overhead rates when your negotiation is based on a difference between what your estimate is and what you actually know by virtue of doing business with a larger company than a smaller one.

What we try to do is set up an average. That is a guide for the buyer to follow. He certainly has a lot more ammunition to work with if he has at least an estimate of what goes to make up the finished product. Then the supplier can show him that his company differs from other companies, and why.

The calculation of profit is made as a percentage (we use 20 percent) of the profit on total cost including material, labor, overhead, etc.

Does that explain it to you?

QUESTIONER: Yes, sir.

QUESTION: You indicated that your central purchasing department does contract for common items.

MR. GOUBEAU: The product departments draw against those contracts.

QUESTIONER: I assume that means, in general, where the common item is fairly well-distributed among your four divisions.

MR. GOUBEAU: That's right.

QUESTION: The particular question is, in those cases where one of your four divisions takes most of the product, let us say 90 or 95 percent, and the others take a very small percent, does the central purchasing department still make the contract, or is it given to the division with a primary interest? If the latter, about where is that breakdown made? In other words, if the primary people have 60, or 90, or 98 percent, or approximately, where is the breakdown made there?

MR. GOUBEAU: I'll tell you what we do. Where 95 percent of it would be purchased by one product department, that product department would buy its own. We, through the medium of negotiating with the supplier, would attempt to get, for the benefit of the other product departments that buy small quantities, the advantage of that product department's large purchases. But we do not attempt to centralize it in order to accomplish that because it is primarily the responsibility of that product department to obtain its materials.

If it is almost an exclusive user, it is not necessary for the General Purchasing Department to step in to do the negotiating for it. In that case, the General Purchasing Agent assists in trying to get price advantages for the small departments in favor of the large. I am speaking of production items, particularly where your specifications might vary. For instance, you may have a condenser, or capacitor, or resistor. There, it would be more a pricing arrangement than a contracting arrangement. We do that.

QUESTIONER: Then you mean that, in general, your agency comes along and pads the original order with the supplier, rather than have the division with a primary interest increase its order originally, and then have the other divisions buy from that main division.

MR. GOUBEAU: Well, we do some of that. As a matter of fact, that is a very logical thing to do, provided you can schedule deliveries: to turn the procurement over to the one department and buy for the other. We do that to a limited degree. But by virtue of our having these separate units, we try to avoid it as much as possible. Buick, for instance, doesn't buy for Cadillac. We try to follow the same principle in our company. But we do it on occasion because it is perfectly logical.

I'll tell you what we frequently do. We frequently, working with that product department from the General Purchasing unit, will arrange with the supplier whereby we will tell him the total usage and actually make an informal contract with him and then the other product departments will merely send the order to him. But it won't be logical, necessarily, to place a contract because of the different types of specifications. You see, when you get into these electronic parts, your specifications vary so much. The Engineering Products Department, where they are manufacturing some airborne equipment for the Air Forces, has to meet Army and Navy specifications, for example. Those specifications would be certainly different from those for our home radio or television sets. Consequently, we try to set it up on a pricing arrangement rather than a contracting arrangement.

QUESTION: During the last two years several of the very large companies decentralized their purchase organization, such as the Ford Motor Company and others. The reason for doing that is to improve their vendor relations and improve their local sources of supply.

Is there any general trend within industry toward either centralization or decentralization?

MR. GOUBEAU: There has been a trend for some years toward decentralization. The National Industrial Conference Board made quite a detailed study of it recently. As a matter of fact, I gave a talk at their annual conference on decentralization. So there is definitely a tendency towards that direction--at least to review the thing.

When talking about the subject, I always counsel: Don't pick a fashion. Rather, let us analyze the problem and see whether or not it is logical. But there is a tendency in that direction. The women, for example, buy dresses short when it is the style to buy them short, and they buy them long when it is the style to buy them long. Sometimes industry is carried away with fashion, too.

Now, decentralization seems to be the thing to talk about. It isn't wholesale by any means. But there is a tendency in that direction, certainly where a company is a large one and is growing and has numerous products and numerous plants.

Life is complex today. You really sacrifice a lot by deciding to keep everything under your wing and not delegating authority. Really, that is all decentralization amounts to--take, for example, the General Electric Company. Harry Erlicher had pretty much centralized procurement. But the General Electric Company is tremendous today and Harry can't possibly manage all of this business. They had to decentralize. They decentralized like we have, by product departments, or by division. Then, beyond that, they have decentralized further down into the plants. They got so big, they had to.

QUESTION: Would you express your opinion, please, as to whether present procurement planning activities in the Armed Services will permit the proper placement of contracts in another emergency?

MR. GOUBEAU: As a matter of fact, I have to be honest and tell you that I am not completely up to date with what is going on in the Services. I don't sell equipment to the Services, so I don't know exactly what is going on. But I do hear about it. I keep more or less up to date with the Navy. I don't see much change in the Navy between wartime procurement planning and what they are doing at the present time. If the Department of the Army is operating as it was during the war, by individual service, as long as they sit on top of their control adequately, I don't see anything wrong with their approach.

The approach through the issuance of the Armed Service Procurement Regulations, I think, is very laudable. It is a very serious problem. I heard enough of it during the war to realize how serious the problem really is. People in industry who are not exposed to that may be a little impatient with it. I realize what a tough problem it is. But I do think that certainly unification of policy and approach has to develop. In other words, do a proper planning job and do a proper procurement job. I don't think one Service should do its buying one way and another Service do its buying another way. Somehow or other, they both can't be right or wrong. There has to be some common approach to it. We don't permit one product department to go off in one direction and another product department to go off in the opposite direction in our company.

Concerning unification, my reaction is that an awful lot of people are talking about something they know very little about. What is it that fellow said? "I know nothing about the subject, so I can talk freely on it." There are an awful lot of people talking about this who don't understand it. My message to the Services would be to concentrate on trying to think alike, anyway.

However, I do see some progress. I am encouraged by it. I am not so impatient as maybe the average person is. But certainly the policies and the regulations have to be united, somehow or other, in order to operate.

QUESTION: Sir, do you encounter any major disadvantages or difficulties in procuring items which are available from many sources of supply?

MR. GOUBEAU: I don't quite understand your question, Colonel. You mean by virtue of scarcity of raw materials?

QUESTIONER: That might be one of them. But supposing there are a thousand different manufacturers of a single item that you are going to procure. Do you encounter any difficulties in procurement when there are so many sources available? Or is it more the other way?

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MR. GOUBEAU: That would be a nice position to be in because then you are in a buyers' market, when there are so many sources.

When an item is available from many sources of supply we select a few excellent sources and obtain competitive prices within those sources. We do not permit everybody and anybody to bid. We are not forced to, of course, because in private business we have the privilege of spending our money to the best advantage of the company. In Government, I realize you have a different problem. However, even in Government common sense should rule and business should not be spread out so thin that the business is no longer precious to your supplier.

But the thing I wanted to bring home is that we concentrate on trying to convince our people not to spread the work out too thin because then the business doesn't mean anything to them. We want to concentrate our business enough so that a person really feels loyal to us. We want him to feel so loyal to us that if we asked him to jump through a hoop he would be willing to jump through a hoop.

I don't know whether I have helped you any or not, but that is my best answer.

QUESTIONER: Thank you.

QUESTION: You mentioned the Armed Services procurement act. Have you any suggestions as to additional provisions that might be added that would assist in obtaining good pricing?

MR. GOUBEAU: No. I think the regulations in the act are quite adequate. Maybe they are too adequate. No, I have no suggestions whatever, I think the act is all right. All you have to do is agree on what to do.

QUESTION: You covered procurement by your manufacturing divisions. How do you handle it for units such as your Princeton Laboratory?

MR. GOUBEAU: I will say, first of all, that each division of the Corporation is separate. The Princeton Laboratory doesn't spend much money in a year's time. Its purchases are small. It sometimes draws on our stocks in Camden or it might draw on our source of supply for its needs. The Princeton Laboratory thus gets the benefit of our volume production, but it does its own buying. We would, of course, help the Princeton Laboratory if requested to do so, but the purchasing problem isn't of sufficient volume to warrant central controls, or anything of that nature.

QUESTION: How much of your budget for the operation of the purchasing organization is spent on research, if any?

MR. GOUBEAU: Research in practical purchasing is a constant function and not a separate function. In other words, we don't set up a separate unit to be thinking about what to buy in the future while the operating unit is buying in the present. And I don't think industry, generally, does.

What we do is to try to have our system so organized that the buyer, particularly the supervising buyer, in a product department has sufficient time to do his planning and research as to how to improve his purchases and how to develop new sources of supply. Our General Purchasing Division assists him in that connection. It is not separate.

QUESTION: In connection with developing sources of supply, you get the vendor in the position where his business means a lot to you. Is there danger in extending that too far, to the point that your business is his major source of business and he continues losing his other contacts to the point that he not only jumps over hoops but you have him over the barrel?

MR. GOUBEAU: Mr. Folsom has several favorite expressions--if any of you know him, you will agree he is a colorful character--and one of them is, "Let's share the worry. If we have a particularly troublesome point," he says, "why should I worry about it if you're going to worry about it too? Let's don't both worry about it. I'll worry about something else." I don't mean to give you a facetious answer, but there is a certain amount of truth to it.

The seller has to protect himself. The buyer has to protect himself to his best advantage. If he is satisfied that by taking the bulk of a producer's output, and his purchase is sufficiently large, where he has other sources, so that if anything happens to him his production line won't go down, it may be very advantageous from the buyer's point of view.

From the seller's point of view, he has to study his customer. It may be that he has enough confidence in his customer and knows from past experience that that customer will always be fair. It will be just the same as if he were a subsidiary of that company. If he has that reliance in that customer, he has no worry about selling his total output to that company. If I were a supplier, I certainly wouldn't want to put my total output in the hands of just any customer because he may be loyal today and disloyal tomorrow.

So I think that it is the seller's own responsibility to protect himself by analyzing his customer. If his customer is reliable, he isn't going to suffer.

QUESTION: I wonder if you would disclose a little more in detail the functions of the price analyst and the engineering estimator in your procurement team?

MR. GOUBEAU: We do not have the procurement team that I mentioned would be desirable for the Services. The main reason we don't have that procurement team is because we usually don't get cost information from the supplier. A manufacturer doesn't want to give his cost information out to another manufacturer. It is very difficult to buy that way in private industry.

What we have is a unit in the--I'll pick the Home Instruments Department because that is where our principal day-by-day volume is; that is where our biggest repetitive items are. In our Home Instruments Department, which manufactures consumer radio and television sets, we have a group which is attached to the financial function in that department. That group has these practical engineers and also has the guidance of the accounting personnel to assist in making up these estimates.

The estimating engineer, working with the accounting people, will obtain from the Purchasing Department the cost of the materials. With the material cost that he gets from the Purchasing Department, the engineer, who has had some experience in manufacturing processes, will figure out how it would be made. By figuring out how it would be made, then he can come up with an estimate of the cost, including the length of time that will be spent in machining or processing it, and so on. Through that means he can come up with a pretty good estimate. It is not so elaborate as when they are talking in terms of a four-inch gun or even a larger piece of equipment.

That is our approach to these components. The estimating engineer obtains his cost information from the Purchase Department. The accounting man helps him. Then he analyzes the type of manufacturing processes and from that comes up with his estimate. The accounting man steps into the picture when he starts to figure overhead, administrative expenses, and so forth.

I think that is about as detailed as I can give it to you.

QUESTION: Do you, in procurement, keep abreast of the peak productive potential of your suppliers in case of expansion?

MR. GOUBEAU: That's right. It is very important. As a matter of fact, our whole philosophy is to live with our suppliers. I keep preaching the doctrine that we should consider that our suppliers are subsidiary companies. The more we know about them, the better we can plan. If we have this loyalty between ourselves, this reciprocal arrangement, we find that is the best type of procurement. That does

not mean you give up buying. It does not mean you give up worrying about prices, or anything else. But the more you learn about what your supplier is doing, the better you are in a position to do business with him and to be guaranteed a source of supply for your production.

Now it is no secret that television receiver production has been mounting by leaps and bounds. By virtue of that, some of the electrical components are becoming scarce. The Military Services also are buying, to a degree; anyway, they certainly are planning on it. The manufacturers of components are getting worried--the resistor manufacturers, the condenser manufacturers, and so on.

In order for us to get some assurance that they are going to be able to support us, we sit down with them and talk about their potential. One thing I learned in 1946 was that there were some companies that just received orders and simply put them in the desk drawer. They never once thought that if they had too many orders they wouldn't be able to fill all of them and someone, in the end, would be hurt. We don't want to do business in that manner.

We have run up against that sort of an operation. When we have, we said, "Look; if you and I are going to continue doing business together, you must plan your production with us, based on what we have told you. If you can't supply the material, tell us. But don't take the order and keep it locked up, then when we want it we find that it isn't ready and our deliveries are late."

I think that is what you are pointing at.

QUESTIONER: No. I meant, rather, keeping abreast of the ability of the supplier to expand in the event your business should expand.

MR. GOUBEAU: That ties in with it. As a matter of fact, we have been talking with different companies, on account of this television situation, about their potential for expansion. That is a constant thing. As long as your buyer is sitting on the top of his commodity and he knows what the manufacturer in that area is doing, and knows pretty much whether he is taxed or whether he needs further expansion, and he talks with him about his plans, you have nothing to worry about.

QUESTION: I have a hypothetical question on common-use items. You have indicated that there might be a point where you are buying in such volume that any increase in volume purchasing would not bring you any increased benefits in the way of prices.

Now suppose you had three purchases in that same category. Would there be any gain in assigning the purchase of all that to one?

MR. GOUBEAU: There are advantages. Again, I would prefer not to enter into this, shall I say, "warm climate."

There are advantages to assigning procurement to a single service. That is what you are talking about. For one thing, when you have more than one service, you can have dislocations in industry. If you assign the purchase to one service, it can then look at the entire industry and look at your requirements, and plan on an over-all basis.

Now you can accomplish procurement by one fellow doing it. You can accomplish it by parallel buying, such as in the case of clothing and textile purchases in New York, where the Army and the Navy discuss what each one is doing. Or you can do it through cross-procurement.

But certainly there are advantages to one service sitting on top of an item, or sitting with the other service, or else handling back and forth for the other service. I would say that there are definitely some advantages because then you can evaluate the entire industry.

True, it is not the only way to do it, but it is one way you can do it.

DR. HUNTER: Your discussion of the importance of establishing satisfactory supplier relationships has been chiefly in terms of the conditions and problems you meet in a rising market.

Suppose you have the reverse of that situation. Suppose we have another 1929 and the years following. The problem takes on a somewhat different character: competition becomes much more keen, more a matter of dog eat dog; each one for himself. How does that affect your policy?

MR. GOUBEAU: The pendulum swings in both directions. When you come into a depression, your regular supplier has to adjust himself to conditions; he has to be competitive. You can retain your loyalty with him so that he can be competitive and sell you on the same basis as the going operation or else he will go out of business. If he goes out of business, he is no good to you, any way. But at least you can plan with him and be loyal to him and not necessarily have to get down to the last dime. You can be reasonably competitive; otherwise, it is foolish to do business with him because he isn't going to stay in business. He will have to let his people go; he will have to cut corners; he will have to cut down his entertainment expenses, and everything else. After all, he may not be down to the last dime.

Our philosophy is, the loyalty of that supplier is worth something. God knows it paid off dividends to everyone who followed that practice before the war and during the war. After the war, he was supported.

So, consequently, I think the same loyalty is present. Naturally the supplier has to adjust himself to conditions. I don't believe, if he is going to be one-tenth of one percent higher than anyone else, in throwing him out and doing somebody with somebody else. I think that should be the last resort instead of the first.

QUESTION: You stressed several times the proper relationships between the prime and the subcontractor in the development of competition. Would you carry that a step further in connection with the allocations programs, that is, the policy as to what we should do in another emergency. Should they try to control the allocation of all those subcontractors to a rather large degree, or should the subcontractors be expected to continue their own relationship? There is a very important problem involved there.

MR. GOUBEAU: I don't think there is any substitute for having the prime contractor carry that load himself and, at the same time, retain the loyalty of his subcontractors. The minute you become a master-mind you upset that arrangement.

However, you do have the problem of the over-all requirement being far beyond the industry's subcontracting facilities, such as you might have in the case of components. There, I think the answer is a close contact between the Services and the prime contractors, working with the subs. But I would not, for one moment, take away from the prime his responsibility, even though you cannot afford to ignore it. If you know you are going to go much beyond the capacity of the industry, you have to bring him in and you have to plan with him about expansion. After you have done that, I would put it back in the hands of the prime contractors.

QUESTION: Your RCA procurement organization is very similar to that of General Motors, I believe. You have a Director of Procurement over the purchasing divisions, the same as they have in the various divisions of General Motors.

Now the question is, in your organization do you work directly under the comptroller or treasurer of the company or work under, let us say, manufacturing or some other office of the firm?

MR. GOUBEAU: I, apparently, will be accused of being a salesman if I keep harping on this thing of relationships. But here I have another opportunity to stress it again. Mr. Folsom and I have talked about suppliers in RCA the same as we did when we worked together in the Navy.

I report directly to the executive vice president. Consequently, that places the procurement function on a very high level. For industry

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generally, I believe procurement should be under the direction of a vice president, who may concentrate on procurement alone. In that case, he would report to the over-all general manager.

QUESTIONER: Yes. The Procurement Director of General Motors reports to the executive vice-president.

MR. GOUBEAU: That is very important. It should be on a sufficiently high level.

QUESTIONER: Yes.

MR. GOUBEAU: The philosophy of the company is reflected in its dealings with those on the outside. They are spending hundreds of millions of dollars a year. They are buying stuff just the same as they are selling hundreds of millions of dollars' worth a year to customers. So you have both sides to consider.

It is very important that that reaches as close to the top, in the way of direction, as possible.

QUESTION: Some of the books in the ICAF Library mention the close tie-up between the Traffic and Purchasing Departments in the big concerns. In yours, how close does your Traffic Department tie in with your purchasing?

MR. GOUBEAU: Traffic reports to me. I tie up purchasing and traffic. The traffic managers of a product department and the purchasing agent either report to a materials manager or else they report to the general manager of the department. So, you see, the traffic manager and the purchasing agent are on an even basis and closely allied. They both report to the same person.

GENERAL HOLMAN: Thank you, Mr. Goubeau, for your very splendid contribution to our understanding of procurement. I think this morning you have given us, in addition to information on procurement, some very valuable thoughts on the philosophy of doing business as well as business organization. This has been really one of the high spots in our course. We are, indeed, very appreciative.

MR. GOUBEAU: Thank you very much.

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