

Chapter 22

The History and Development of Purchasing Management and Its Theoretical Framework: A Review of Transaction Cost Economics

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ABSTRACT

Purchasing as a management or academic field of study has seen a rise in its awareness. The strategic role it assumes in most organizations and businesses is as a result of the need for firms to reduce cost and to counter increased competition. However, this recognition evolved from ‘humble’ beginnings up to the strategic importance it assumes today in some organizations and as a major field of study in the academia. The historical development of purchasing is worth studying so as to better understand and appreciate the important role it now assumes. Much literature and many theoretical frameworks have been developed to help explain various phenomena in the purchasing field. Transaction cost economics is one of such theories that have been applied. The contribution of transaction cost economics to the growth of knowledge in the purchasing and channel studies has been enormous.

INTRODUCTION

The advent and the growth of purchasing as a research/academic field of study and the attendant strategic role it assumes in most organizations and businesses of today cannot be underemphasized. The importance and recognition of the purchasing function by senior management has become necessary as a result of the need for firms to reduce cost and to counter increased competition from both domestic and international firms (Heberling, 1993). Academic research and studies have also had a ‘ripple effect’ in the purchasing field as a whole as managerial implications and issues of relevance to public policy are considered. The growth of the purchasing field has seen some tremendous uplift both in the theoretical and policy/managerial domain. Therefore, this chapter seeks to trace the historical development of purchasing management and make a review of one of the key theoretical frameworks that is used in purchasing management literature and research – transaction cost economics (TCE).

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This chapter consists of three main sections. Section One provides a general background on the development of the purchasing field with respect to historical development of industrial purchasing; the emergence of business-to-business/industrial marketing and the organization of industrial purchasing. This section also discusses purchasing's evolvement from a clerical buying function into a strategic business function and highlights the role of the buyer, academic/research and professional associations. Section Two investigates the historical and recent development of TCE and some conceptual/empirical studies utilizing TCE. Transaction cost theory has seen a rise in its application not only in purchasing and supply chain management but has over the past two to three decades been used generally in inter-firm studies, buyer-seller relationships and marketing channels. Section Three contains the Conclusion.

HISTORICAL DEVELOPMENT OF INDUSTRIAL PURCHASING

The development of purchasing as a field of study and a profession all started with industrial purchasing with significant contribution from the field of marketing. Philip Kotler's (1967, 1972, 1976) very popular and one of the most frequently used marketing textbook: *Marketing Management: Analysis, Planning and Control* chapter on producers, resellers, and government markets sets the tone for the agenda on business marketing. Purchasing started with the emphasis on marketing philosophy where the product concept was very dominant during the 1850-1915, followed by the era of the selling concept (1916-1960) and the new concept of marketing after the 1960s.

The Period 1850-1915 (The Product Concept)

The product concept period was marked by production orientation. The expansion of mileage of railroads; the rapid development of the steel industry; the increase in population; developments in communication and transportation especially in the USA spurred the rapid expansion of markets and the use of mass production techniques. The availability of electric power coupled with the development of better machinery led to the mechanization of manufacturing processes and procedures, notable being the automobile industry (Weeks & Marks, 1969).

The era of the product concept was characterized by firms concentrating on how best to efficiently produce goods without much thought on how to sell or market those goods that were produced. Hence, the focus was on how to produce rather than how to solve the problem of selling the goods or providing some level of customer service. For example, the emphasis on efficient production and price typifies Ford's production technology such that "between 1909 and 1914, Ford's mass production method reduced the retail price of the Model T from US\$950 to US\$490 leading John D. Rockefeller to call Ford's Highland Park plant the industrial miracle of the age" (McIntyre, 2000, p. 269).

Despite the reduction in Model T's price as a result of the new production methods, mounting customer dissatisfaction with dealer service threatened to reduce the sale of the Model T automobiles. During this period, many firms expanded in size so as to control the emerging markets and to gain increasing economies of scale. Consequently, excesses began to show in the production capacity of these firms. This led to the ushering of a new era where sellers begun seeking out new buyers. Advertising and personal selling, therefore, became of much importance to most of these firms (Weeks & Marks, 1969).

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