Economic Anchors and Vendor Contracting: New Barriers (and Potential New Opportunities) for Small Minority Business in the New Economy

Russell Williams
Senior Research Fellow

Community Enterprise Technical Assistance Collaborative
Center for Urban and Regional Policy
Northeastern University

May 2001
Executive Summary

The “New Economy” has affected many aspects of corporate activity. One of the most important, but often overlooked, is corporate purchasing from suppliers. Serving as one of the major ways in which employment and income are diffused from large firms to the local economy, purchasing operations are not only the lifeblood of small businesses with supply contracts, but contribute to economic well being within the entire urban area.

This report illuminates the impact of our changing economy on purchasing operations, the ways that these changes are affecting links between corporations and their suppliers, and the resulting implications for the current and future potential of minority businesses to gain access to supply contracts. The focus on minority businesses is particularly important because, with the city of Boston now more than half non-white, the long-term economic fortunes of the city are increasingly being recognized as dependent on the diffusion of economic activity across communities of color. Based on interviews with purchasing directors in some of Boston’s key corporations, the report covers major developments affecting purchasing in three of Boston’s leading industries: health care, banking and insurance, and higher education.

Two factors turn out to be critical in understanding the challenges and opportunities faced by minority vendors in the new economic environment. First, institutional mergers in the health care and banking industries have led to an increase in the scale of corporate purchasing orders, resulting in comparatively fewer opportunities for small businesses to win vendor contracts. (Similarly, the merging of buying power across institutions through increased use of buying consortia in the education and health care industries has also reduced opportunities for small businesses.) Second, the growing use of advanced technology for accessing, processing, and communication of information is rapidly leading major corporations to require corresponding e-commerce capabilities among its vendors. As this trend continues, suppliers and potential suppliers who do not have such capabilities will lose the competitive advantage gained through other features of their businesses and will face increasing hurdles to obtain and maintain contracts.

These new developments represent new potential barriers to the full inclusion of minority businesses in the economy, and also represent an important juncture in the economic life of the city and region. The challenge for the future of economic inclusion involves not only addressing current discrimination, and addressing the lagged effects of past discrimination as they have been manifested in the past, but also requires taking strides to bridge the new obstacles -- including the digital divide -- that reinforce past inequalities.

On the positive side, these new developments in corporate purchasing also present fresh opportunities to intercede in these particular aspects of business asset formation and to try to limit the replication of past patterns of inequality. Important creative thinking, directed action, and collaboration can be undertaken by major corporations, individual business owners, government agencies, and other institutions to enhance healthy economic activity across the city and region.
Economic Anchors and Vendor Contracting: New Barriers (and Potential New Opportunities) for Small Minority Business in the New Economy*

Russell Williams
Senior Research Fellow
Center for Urban and Regional Policy
Northeastern University

Introduction

During the past decade, the American economy has undergone dramatic change, including adaptation to new technology, increased global competition, and a shift toward more service-based industry. These changes have affected many aspects of corporate activity and have implications not only for the internal operations of corporations, but for external parties who interact with these large institutions on a regular basis.

Corporate purchasing is one very important, but often overlooked, function affected by the changing dynamics of the economy. The contractual links between large corporations and the businesses supplying them with goods and services are among the major ways in which economic activity is diffused to the local economy. According to a publication of the Greater Boston Chamber of Commerce, firms that supply goods and services to the economic anchors of Greater Boston provide one of every nine jobs in the region.1

* The research for this report was carried out under grants from The Boston Edison Company and the Ford Foundation. We gratefully acknowledge their support for this project. Interviews were conducted by the author and Greta Meszoely, whose contributions are greatly appreciated. The author particularly thanks the interviewees at various corporations for their time and insights. Additional thanks are extended to Christiane Leup, Walter Lind, Barry Bluestone, and Charlie Euchner.

This report, based on interviews with purchasing directors in some of Boston's major companies, illuminates the impact of the changing economy on the potential of minority and small urban-based businesses to gain access to supply contracts. Because of the relationship between purchasing by economic anchors and the economic status of the rest of the economy, significant changes in purchasing procedures can have substantial effects on many aspects of urban economic activity. These implications are important not only for individual suppliers to large corporations, but also, when seen overall, for the geographic and social distribution of economic wellbeing.

Two factors turn out to be critical in understanding the opportunities and barriers faced by small minority vendors in this new economic environment. One has to do with the increase in mergers among large corporate institutions in key industries. The other is related to the role of new information technologies -- in particular, e-commerce and electronic business-to-business (B2B) links -- as the means for connecting vendors to major corporations. As this report will suggest, the growth in mergers threatens to reduce the opportunities for small minority businesses to win vendor contracts as the number of large discrete corporate entities declines and the average size of supplier orders increases. Similarly, as larger corporations and institutions demand that their vendors fully utilize e-commerce as the chief means of sales, shipping, and accounting, smaller suppliers left on the wrong side of the "digital divide" are threatened with possible extinction. Just as inner city businesses are beginning to actualize previously existing capabilities and/or to develop new capability to supply major corporations, they may face new barriers because of institutional mega-mergers and the limited diffusion of information age business applications. Alternatively, if the digital divide can be crossed, new opportunities for local small business could be substantially enhanced.
Major Businesses and Vendor Purchasing

In modern economies, the major contributors to urban economic health are the firms that export their goods and services beyond the boundaries of their community. In every city, a number of businesses establish large volume trade with other cities, regions, and countries, utilizing productive capacities deriving from each urban area’s unique combination of physical, social, and historical attributes. The export of manufactured goods and/or services from these businesses results in a flow of payments from other locations that ends up as a major source of income for the city.

This export-based income in turn helps sustain trade within the city. The wages and salaries paid to employees by export-oriented business contribute to the consumer demand that fuels local business operating within the community. In a real sense, the local hairdresser, pharmacy, grocery story, and daycare center depend on exporting industries to generate the income for the local goods and services households buy in their own community. The computer programmer who works at John Hancock helping to process claims from all over the country earns income generated from the export of service that can be used to purchase lunch at a local diner.

In addition to the income flowing from exported goods and services, and the income circulating from local consumption, there is another important income flow -- from a city’s export businesses directly to local businesses in the same city. Given the volume of income flowing through a city’s economic anchors, it is particularly important to assess the flow from these largest businesses to other businesses that act as their suppliers or vendors. Large export-oriented businesses require a huge supply of inputs -- in the form of durable goods, non-durable goods, and services -- to carry
on their tasks. Traditionally, a substantial portion of these goods and services are purchased from smaller local businesses. The purchasing departments of the large corporations are responsible for this link between the economic anchors and their suppliers, through their role in procuring goods and services for their corporations.

As noted earlier, supplier firms providing goods and services to the economic anchors of Greater Boston provide one of every nine jobs in the region. The supplier base of the local economy is economically important not only because it constitutes a large flow of trade, but also because it stimulates the growth of entrepreneurial talent, provides local employment, and creates the potential for local vendors to grow into larger exporters themselves. Thus, purchasing contracts from export base anchors to local suppliers can be thought of as a form of investment in the equity position of local businesses. In this way, they can be critical to the prosperity of local neighborhoods and communities.

There are some indications that the economic importance of the purchaser/supplier connection may be increasing. While the leading industries in Greater Boston increased their employment by 9.2 percent between 1993 and 1997, employment in their supplier industries increased by 21 percent. This reflects a growing trend toward outsourcing of corporate activity to specialists and to lower cost producers. It provides a superb opportunity to local firms -- if they can successfully compete for this business.

Who benefits from this increase in outsourcing is critical. While entrepreneurial spirit exists in every community, historically many minority businesses have faced numerous obstacles to survival

---

and to expansion. Historically, many have faced discrimination in the capital market, making it difficult to expand. Often customers from outside the immediate community shy away from minority firms out of ignorance or bigotry. In other cases, minority firms are excluded from potentially useful information, barred from influential networks. Such businesses typically have had to follow what some authors call an “economic detour” following their dreams of building a business on different, more difficult, and less stable terrain. With most of their number constrained to “ethnic niche” consumer markets, providing goods and services on a relatively small scale, minority businesses have nevertheless historically provided an important source of production, employment, and income in minority communities. However, the size and scope of this economic activity frequently is constrained because of an inability to expand their markets beyond the immediate neighborhood and inability to form stronger economic ties with the large export anchors in the regional economy.

In recent years, as the demography of Massachusetts has changed, there has been growing attention to the economic importance of the expansion of minority business economic activity, including the inclusion and full participation of minority businesses in supply contracting and in export. Discussions have taken place both within some individual businesses, and in organizations like the New England Minority Purchasing Council (NEMPC), and the Purchasing Managers Association of Boston (PMAB). These discussions have been spurred partially by a sense of righting past exclusion, but also increasingly motivated by long-term corporate self-interest in an environment of changing racial composition. With the city of Boston now more than half non-white, the long-term economic fortunes of the city are increasingly being recognized as dependent on the diffusion of economic activity across communities of color.
Recently, several reports have emphasized the consumer potential of inner city communities, and the potential profits to be made from the consumer base in these communities. However, meaningful business development should focus not only on consumer base industries, but also upon supplier firms that already contribute activity to the Boston economy. Healthy economic development should not only provide jobs to economically-challenged communities, but also stimulate community-based businesses, unlocking many layers of untapped economic potential.

If these efforts are to be made, however, the steps taken must be made with full awareness of the changing landscape of purchasing, and of the economic forces that are changing purchasing departments' perspectives on the desired characteristics of suppliers.

**A Survey of Purchasing Agents**

In order to grasp the rapid changes in purchasing and their implications for suppliers, we conducted a set of interviews in and around Greater Boston with purchasing managers in health care, education, and in finance/insurance industries. Our objective was to determine how purchasing was changing and what motivated such changes in function and operation. While this survey was not based on a random sample of such firms, those we interviewed suggested their experience was not atypical of their industries.

---

The Health Care Sector

Health care is Boston’s leading industry in terms of employment and revenue. Because of its national and international reputation, it is also one of the city's major "export industries." Patients come to area hospitals and clinics from all over the region, the nation, and the world. The city's health care industry includes 27 in-patient hospitals, 25 health clinics, and a number of large health maintenance organizations. In addition to its prominent role in patient care, Boston is also the largest health research location in the nation.4

The health care industry provides one of every seven jobs in the city (97,000 total in 1998).5 Three of the four largest employers in Boston are hospitals (Massachusetts General Hospital with over 11,000 employees, Beth Israel Deaconess Medical Center and Brigham and Women's Hospital with approximately 9,000 employees each).6 With the inclusion of three other hospitals (New England Medical Center, Children's Hospital, and Boston Medical Center), health care institutions rank as six of the twelve largest employers in the city.

The medical industry purchases a huge number of goods and services, with the leading items being medical instruments and devices, pharmaceuticals, and office supplies. A recent study by the South End Neighborhood Action Program indicates that the Boston Medical Center alone purchases over $200 million in goods and services. Partners Health Care had operating revenues of nearly $2.8 billion in 1999, spending more than $700 million of this total on purchased supplies

---

4 Greater Boston Chamber of Commerce, "Greater Boston’s Leading Industries: Drivers of the Regional Economy, 1999-2000".

5 See Boston Redevelopment Authority, "Boston's Economy - 1998".

6 As reported in 1997.
and contracted services. The Partners' figures, if they are typical for the industry, indicate that upwards of 25 percent of revenues are spent on procurement from suppliers and vendors.

Health care, however, is going through substantial changes affecting the quantity and structure of its purchasing operations and objectives. The changes are being driven by greater competition and by factors associated with Federal and state reimbursement policy.

According to the purchasing officials with whom we talked, the fact that several Boston hospitals are among the leading medical research and teaching hospitals in the world has major implications for the hospitals' financial operations. As the leading institutions for the diagnosis and treatment of illnesses, it is very important that they have the latest technology. However, under the health plan structures dominant today, reimbursements from HMOs and other insurance carriers tend to lag behind the costs of the cutting-edge technology. Because of this, the teaching hospitals are now prone to large financial losses. This situation has worsened since the late 1990s as a result of Congressional efforts to balance the U.S. Federal Budget through major reductions in Medicare and Medicaid reimbursements.

Consequently, there is a great emphasis on minimizing costs throughout the industry, and particularly the costs of non-medical supplies and equipment. As one interviewee commented with respect to hospitals' efforts to reduce costs, "You go first to supplies, and then to people."

The emphasis on reducing the cost of supplies has led most Boston hospitals to join national group buying consortiums. The two largest of these are Novation, which handles contracts for 6,000 various health care organizations (a total value of $14 billion of contracts), and Premier, which

---

7 See Partners Healthcare 1999 Financial Report from Partners Healthcare webpage (www.partners.org). Partners Healthcare comprises Brigham and Women's Hospital, Massachusetts General Hospital, North Shore Medical Center, Newton-Wellesley Hospital and Faulkner Hospital.
handles purchasing contracts for 1,800 non-profit hospitals nationwide. The impact of these consortia on the access of local small vendors to contracting possibilities is substantial.

According to the purchasing officials we interviewed, as part of their contracts for a given item with a consortium, many hospitals commit to purchasing at least 80 percent of their volume for that item from the buying consortium. The national group buying consortiums cover a large range of office supplies, making it less likely that smaller vendors with a smaller range will be able to gain contracts. A purchasing official at one of the hospitals estimated that across all hospital purchases of goods and services, a large national purchasing group could handle 30 percent of a hospital’s total supply needs. The volume is so large that many of the subcontractors to the consortia are themselves very large national firms such as Staples and Office Depot.

In addition to utilization of national buying consortia, cost considerations at individual health care centers and mergers of medical facilities have encouraged and facilitated the formation of local and regional buying consortia. For example, the Beth Israel Deaconess Medical Center (BIDMC) -- which used to be two distinct hospitals (Beth Israel Hospital and Deaconess Hospital) -- now belongs to the Premier group purchasing consortium at the national level and to the Care Group (comprising BIDMC, Baptist, Glover, Nashoba, Waltham and Mt. Auburn Hospitals) at the local level. Boston Medical Center (the result of a merger between Boston City Hospital, Boston University Medical Center, and Boston Specialty and Referral Hospital) is a member of Premier at the national level and Yankee Alliance at the local level. Brigham and Women’s Hospital belongs to Novation at the national level, and to Partners Health (which handles purchasing for Brigham and Women’s Hospital and Massachusetts General Hospital) at the local level.

---

8 The remaining 20 percent is recognized as possibly involving products requiring specifications that may not be available from the consortium.

9 As mentioned in a previous footnote, the Partners Health group includes Newton-Wellesley Hospital and North Shore Hospital. However, these two hospitals handle their own purchasing rather than going through the Partners purchasing department.
In those contracts where supplies for hospitals are not being bought through the national and local purchasing consortia, many hospitals are increasingly using large or mid-size distributors to buy supplies in large bulk. According to the purchasing managers we interviewed, there are two incentives to purchase in this manner. One is lower direct costs due to the fact that the vendor companies are willing to offer lower prices in exchange for higher volume. The second is lower overhead costs as the number of separate transactions is reduced and purchasing operations at the hospitals are streamlined. When dealing with one distributor (or a small number of distributors), there are fewer bills to process, fewer individuals needed to track delivery, and fewer relationships to maintain. This lowers the transactions processing workload of the purchasing departments, allowing hospitals to achieve purchasing goals while utilizing fewer staff. The emphasis on large distributors to obtain the advantage of lower price and streamlined operations mean that fewer small vendors have access to consideration for contracts.

Hospitals continue to examine their purchasing systems for potential cost reductions. Purchasing officials told us that in the fast approaching future, administrative overhead costs (for example, space and the costs of handling transactions) will be streamlined further through increased use of the Internet to order supplies. Typically now, the large office supply companies provide an on-site representative to insure speedy communication and next-day desktop delivery. While this adds efficiency to communications and problem-solving efforts, it also uses valuable space within the hospitals. There was general agreement that in the near future, the use of Internet transactions would give hospitals the potential to reclaim needed office space currently devoted to the on-site supply company representative. One interviewee said, “In the future, there will be no need for an on-site rep.” Another interviewee emphasized the reduction in paper and paper-processing time that increasing use of the Internet offers, stating “That’s the wave of the future—to be able to point and click on your products to order them, and to do your payments on-line”.

The Banking and Insurance Industries

Boston is one of the leading financial centers of the United States. The economic landscape of Boston includes such financial powerhouses as Fidelity Investments (the third largest employer in the city), Fleet/Bank Boston (one of the five largest employers in the city), Liberty Mutual Insurance Company, John Hancock Mutual Life Insurance, and others. Four of the city's top ten largest employers -- and six of the top twenty largest employers--- are in the finance/insurance industry.10

With Boston's financial/insurance industry including the largest mutual fund company in the country, one of the largest banks in the country, and two of the largest insurance companies, the finance/insurance industry draws funds from around the world for various demand deposit, investment, insurance, and other financial products.

There is substantial purchasing of supplies and services by this industry. According to the purchasing directors with whom we talked, financial institutions spend about 30 percent of their revenue dollars on vendors. Thus, as is true for the local health care sector, developments that affect purchasing by the finance/insurance industry from local suppliers of goods and services have important implications for the dissemination of economic activity to the rest of the local economy.

10 Fidelity is the third largest employer, Fleet/Bank Boston is one of the five largest, Liberty Mutual ranks ninth, John Hancock ranks tenth. Putnam Investments and State Street Bank are also in the top twenty.
The financial industry is in the midst of major structural changes. To date, these changes have been of particular note in the banking sector, where events during the 1980s and 1990s have revolutionized banking structure. However, purchasing managers interviewed for this report and industry analysts writing about the financial sector emphasize that there are many changes to be expected soon in other parts of the industry that originate from the same developments.

The banking sector includes commercial banks, savings banks, savings and loan institutions, cooperative banks, and credit unions. Among the widely-known important developments have been two waves of bank failures, experienced by savings and loan banks in the 1980s, and by commercial banks in the early 1990s. These failures have contributed to consolidation of banking activity as failing institutions were acquired by more viable ones. However, less widely known to the general public are the deeper underlying developments that have influenced not only banking consolidation but also the structure of purchasing links with supplier businesses.

One of the most important developments for purchasing in the banking sector of the financial industry has been a sharp decrease in the number of banks as a result of mergers and acquisitions. The consolidation of the banking sector in the past two decades has been considerable, and mergers and acquisitions within banking are continuing. Currently, Massachusetts has only half the number of banks as there were twenty years ago. While there were 451 banks in the state at the end of 1980, by the end of 1990 there were 335, and at the end of 2000 there were only 228. When credit unions are included the figures still show a 50 percent decrease -- from 1066 in 1980, to 748 in 1990, to 513 in 2000.11 The statewide trend of mergers and acquisitions during these

years is reflective of national dynamics; between 1980 and 1998 there were approximately 8,000 bank mergers in the U.S., and during the single recent year of 1997, there were almost 600 bank mergers in the U.S.\textsuperscript{12}

\begin{table}
\centering
\caption{The Decline in the Number of Financial Institutions in Massachusetts}
\begin{tabular}{|l|c|c|c|}
\hline
 & 1980 & 1990 & 2000 \\
\hline
Commercial Banks & 135 & 84 & 42 \\
Savings Banks & 162 & 149 & 105 \\
Saving and Loans & 35 & 7 & 5 \\
Cooperative Banks & 119 & 95 & 76 \\
Credit Unions & 615 & 413 & 285 \\
\hline
\end{tabular}
\end{table}

Source: Federal Reserve Bank of Boston, Research Division

This reduction in the number of banks has not been caused by a diminution in bank industry assets. In fact, the total assets of Massachusetts' banks have increased by $16 billion in the past ten years.\textsuperscript{13} Instead, mergers and acquisitions have been fueled by three mutually reinforcing developments: changing technology, changes in patterns of capital formation by businesses, and changes in state and federal regulations governing the financial industry.

"The key to banking today is automated banking," one bank purchasing official emphasized to us during our interviews. Changing technology has transformed the processing volume, speed, and complexity of banking transactions. The ability to access and manipulate large databases, to


\textsuperscript{13} Data provided by Ellen Lovett, Boston Federal Reserve Bank Research Division, January 4, 2001.
heighten accuracy, and to lower the costs of processing information provided not only the ability to expand banking markets, but also economies of scale that provided advantages to increased size. Associated with this change have been technological developments such as ATM’s and electronic banking via phones and/or the Internet. These developments have greatly reduced the need for interpersonal interaction and local presence, facilitating the growth of banks and mergers between banks. “Technology is the fundamental force driving the merger wave,” was the insight of one Federal Reserve Bank president, given to an audience in 1998.14

Another key development in the banking sector has been the changing pattern of raising corporate capital. Many financial innovations occurred in the late 1970s, including the creation of money market mutual funds, cash management accounts, and other forms of creating finance. These innovations competed with traditional banking products, providing attractive alternatives for business capital formation, and changing the major focus of business products from bank loans based on funds from demand deposits to commercial paper based on money accumulated from mutual funds. This competition from new financial products led to pressure from the banking industry on Federal and state authorities to change what were increasingly seen as antiquated banking regulations.

This led to the third major development contributing to bank consolidation -- changing regulations affecting the banking sector and the rest of the financial industry. Twenty years ago various types of banks existed side-by-side because of regulations preventing the mixing of commercial, investment, and insurance banking. Banks specializing in deposit accounts, for example, could not

engage in the underwriting of corporate bonds. Beginning in 1981, changes in regulations removed various barriers to the potential participation of banks in multiple arenas of financial activity, and removed barriers to expansion of banks across state lines. Meanwhile changes in technology created the practical opportunities for banks to act upon these regulatory reforms.\(^{15}\) Key events in the move to change laws included the liberalization during the 1980s of state regulations governing ownership of banks by bank holding companies, elimination of interstate banking restrictions in 1994, and the repeal in 1999 of the Glass-Steagall Act, which had required the institutional separation of commercial banking, insurance, and investment banking. These changes have led to the possibility of an increasing range of financial activity within banks, a possibility actualized in some cases through mergers, and to increasing competition among banks to offer a variety of financial services, which in many cases has also led to mergers and acquisitions.

These changes have had -- and will continue to have -- major implications for purchasing by banks and for the efforts of local businesses to gain supplier contracts. “The effect of the mergers is being played out at a variety of levels,” one bank purchasing official emphasized during our interviews.

The mergers mean that there are fewer institutions seeking vendors -- instead of more than 1,000 Massachusetts banking institutions making separate decisions about what contractors to use, as there were in 1980, there are now only roughly 500 institutions making those decisions. As banks have been consolidated, purchasing departments have been consolidated, and contracts have been

consolidated. Fewer contracts are being put out by the banking sector, and consequently there are fewer available opportunities to get contracts.

According to the purchasing managers we talked to, bank mergers have led to re-evaluation by purchasing departments of who the banks use for subcontracting, to see if goods and services may be available more cheaply. The re-evaluations have resulted in a closer assessment of the potential for volume discounts, more formal purchasing procedures, and fewer decisions based on personal relationships.

Information technology has been a major factor in the restructuring of the banking industry, and technology applications are a major focus of competition among banks and between banks and other financial services businesses. According to our interviewees, banks spend roughly 60 percent of their purchases on technology and related services. It is not surprising, therefore, that an important aspect of internal operations of banking is on maximizing the usefulness of this technology for applications within the bank, including purchasing.

Like the purchasing officials in hospitals, the bank purchasing officials see information technology as being an important source of efficiency and an important prerequisite for future purchasing. Our interviewees cited several ways in which the efficiency was important -- reduction in filing space and filing costs, reduction in mailing costs, paperwork processing reduction, billing efficiency, and time management for the bank purchasing staff. "I don't want to spend time on the phone waiting for you to fill out forms," said one official. The bank purchasing officials emphasized that information processing is becoming more important. "If you can't send information online, and get it to me overnight, you're not even on the radar... The technology gap
is a real problem for some businesses [seeking contracts]. Experience is not enough,” one official stated.

The importance of information technology in transforming future vendor activity was echoed by purchasing directors in the insurance industry. One such official commented on the inclusion of information technology in corporate expectations. “It’s going so fast, it takes your breath away...and it’s accelerating! The speed I see it happening with is phenomenal.” He further commented on the role of information technology generally “Every major spender in this town is going electronic.... Fifty percent of [our company’s] transactions now are done on the Internet. It is not a requirement today, but within the next 3 to 4 years, it will be prevalent.... Purchasing is moving to contract negotiations and technology skills.... If suppliers don’t have the skills, you can’t do business with them.”

It is also expected that there will be further consolidation within the financial industry, including not only banks, but also other sectors of the industry. The repeal of the Glass-Steagall Act by the Gramm-Leach-Bliley Financial Services Modernization Act, occurred in November 1999. The ramifications for the structure of financial services have not yet been fully seen. It is expected to lead to more mergers and the establishment of banks with branches across the nation. However, it is also expected to have effects beyond the banking sector. A recent article in the Economic and Financial Review states “the new legislation [the Financial Services Modernization Act] could accelerate the merger of firms across the financial services industry (in contrast to the recent mergers within the banking sector).”

The Education Sector

The city of Boston is home to 35 institutions of higher education, with a combined enrollment of approximately 141,000 students in 1997. Eighteen of these institutions have enrollments of over 1,000 students, led by Boston University (29,000), Northeastern University (26,000), and the University of Massachusetts-Boston (12,500). There are an additional 40 higher education institutions in the Boston suburbs, constituting a total of 75 educational institutions in the Boston metropolitan area and a total metropolitan enrollment of over 250,060 students.

These institutions have significant economic impact on the city of Boston and the rest of the metropolitan area. More than 35,500 jobs in Boston come from institutions of higher learning. Boston University is the fourth largest employer in the city of Boston, while Northeastern University is the fourteenth largest. Many of the colleges and universities attract research grants

---


18 According to "Boston’s Economy 2000", Boston Redevelopment Authority, May, 2000, p. 9 there are approximately 33,000 jobs in private institutions of higher learning. The author called each of the public colleges/universities in Boston to obtain approximate figures for those institutions.
and other sources of funding that add to the city's economy. The educational institutions also bring in students from around the world who consume local goods and services.

Educational institutions are also a major source of contracts for local businesses. Purchasing includes office supplies, construction, printing, computers, laboratory supplies, furniture, and many other items necessary for dormitories, classrooms, and administrative purposes, as well as a wide array of services. Recently, many colleges have sought to outsource some of their services, further increasing the amount of contracting conducted by the education sector.

The various colleges, community colleges, institutes, and universities vary considerably in size, histories, and educational foci. We interviewed purchasing directors at Northeastern University (a large university), Wentworth Institute (a mid-size technological institute), and Emerson College (a mid-size college focusing on communications and the arts). While there were a number of differences in purchasing among the educational institutions we visited, some clear trends are also apparent. Among the important developments are a growing utilization of e-commerce, growing use of procurement cards, and an increased use of buying consortia.

There is a very strong trend toward Internet-based purchasing. For example, Northeastern University is rapidly moving toward more Internet-based contract interactions, and in the future, Internet capabilities will be a requirement for many types of contracts. The purchasing directors emphasized the more efficient use of time that point-and-click ordering provides, and the improved accuracy of billing. Procurement systems based on Internet capabilities provide the possibility of decentralizing the initiation of transactions, while maintaining exclusive contract relations with selected vendors and also, through instantaneous information flow back to the purchasing
department and other appropriate offices, maintaining the important functions of centralized monitoring and reporting.

In addition to the steps that colleges and universities are initiating, our interviewees noted that colleges are beginning to be solicited by e-trade Internet companies. The potential benefits to colleges and universities of Internet based transactions are being seen not only by the colleges themselves, but also by various companies.

Purchasing by educational institutions is also being changed by the use of procurement cards. Essentially a credit card linked to a specific department, giving limited purchasing authority to the user, procurement cards reduce paper work by eliminating the need for requisitions, while maintaining a flow of information that allows monitoring and efficient reporting. Procurement cards thus improve the efficiency of department staff, purchasing staff, and accounting staff, and are being adopted by an increasing number of colleges/universities. Our purchasing department interviewees emphasized that companies seeking contracts from educational institutions in the future should be prepared to handle both Internet-based ordering and procurement card ordering.

A third development pointed out by our interviewees in the education sector is the fact that, like purchasing in health care, there is increased use of buying consortia by education institutions. One of the major recent developments contributing to the use of buying consortia was 1998 legislation opening up participation in the Massachusetts Higher Education Consortium (MHEC). Among the current members of this consortium are more than a third (13) of the educational institutions located in Boston: Berklee College of Music, The Boston Conservatory, Boston University, Bunker Hill Community College, Emerson College, Massachusetts College of Art, the
Massachusetts College of Pharmacy, Roxbury Community College, the School of the Museum of Fine Art, Simmons College, Suffolk University, UMass-Boston, and Wentworth Institute.

Founded in 1976 by the purchasing manager at the University of Massachusetts in Amherst, the MHEC was initially designed to help public colleges and universities engage in bulk contracts. By 1997, through the inclusion of some private institutions that were accepted as purchasing affiliates of the public colleges and universities, MHEC membership had expanded to 57 members. A year later, the Massachusetts legislature passed Chapter 194 of the Acts of 1998, allowing MHEC to expand its membership to more private colleges within the Commonwealth. As a result, by the beginning of 2000, MHEC had grown to include 76 educational institutions.

Our interviewees noted that there are three attractions to the MHEC consortia, particularly for colleges with a small number of purchasing staff. First, contracting through MHEC's group contracts saves negotiation time with vendors since the negotiations have already been done by MHEC. Second, the existence of completed contracts adds to efficiency because "you don't have to spend a lot of time drawing up contracts." Finally, membership in MHEC helps colleges obtain lowest prices because even if colleges choose not to use a specific contract and selects a vendor who is not an MHEC contractor, that contractor has to match MHEC prices and/or services in order to be competitive for the contracts.

Even among schools that do not take part in consortium buying, there is increased pressure for vendors to offer low prices. According to our interviewees, both line staff and purchasing department staff are much more educated about goods and prices than they used to be because of information access via the Internet.
The Evolving Role of Purchasing Departments and Implications for Suppliers

Historically, the role of many purchasing departments was to process purchases — to do the paperwork associated with purchases, to handle delivery issues, and to achieve cost reductions through bulk purchasing of selected high volume items. More recently, however, changes in information access and information processing power, changes in the structural characteristics of industries, and changes in competitive strategies have led to an evolution of purchasing roles, objectives, and practices.

Purchasing departments can now retrieve and process information in larger volume and at faster speeds, enabling purchasing offices not only to be more knowledgeable about expenditures but also to provide feedback on expenditures to upper management more rapidly and accurately. This has empowered purchasing departments to contribute more directly to the strategic goals of the corporation. Increasingly, purchasing departments are important centers for discussion about cost reduction, the incorporation of new technology, and overall efficiency.

As information technology affects the purchasing department role in the organization, it is also affecting the structure within purchasing departments. Among the central challenges facing many purchasing offices are the streamlining of staff and operations and the need to identify innovative ways of handling large dollar values of purchases while still remaining sensitive to the specific needs of line managers.
Accordingly, many of our interviewees mentioned: 1) centralization of contracts under purchasing departments with an emphasis on reducing the number of transactions, 2) a focus on using information about past and potential purchasing to contribute to the bottom-line, and 3) decentralization of buying decisions within contract guidelines established by the purchasing department. The use of information technology within the corporation is key to this decentralization. Information technology can provide added information to the decentralized buyer and can increase the number of visible options, while limiting these options to contract parameters -- thus providing centralized control of purchasing across the corporation. Furthermore, the purchasing department can obtain instantaneous information about requested items. The process reduces the amount of time required within the company for the purchasing department to negotiate with line managers regarding what the line manager needs, speeds up ordering, and improves record-keeping. The advantage to the corporation is that the use of information technology and the implementation of other new administrative techniques by purchasing departments boosts productivity, cuts costs, and improves planning.

As corporations pursue these goals involving their purchasing departments, they will require suppliers to do various things to mesh with the cost cutting efforts. Abilities of suppliers to provide those things are rapidly becoming a requirement for contract consideration. Suppliers who do not mesh well with the new developments in purchasing in effect lose the competitive advantage gained through other features of their businesses and will face increasing hurdles to maintain and expand their existing contracts.

SUMMARY
Some general themes that emerged from our interviews with purchasing directors are:

1. There is a heavy emphasis on cost reduction through efficient purchasing. This has contributed to the use of information technology within the corporation and is now a major factor in an accelerating trend toward the use of e-commerce between the corporation and its suppliers. This has a number of efficiency advantages to the corporation, including less paperwork, improved tracking of transactions, fewer staff, faster response, and fewer mistakes.

2. In some sectors, mergers have led to the consolidation of previously separate purchasing departments, an increase in the scale of purchasing orders, and increased use of large suppliers to meet those needs.

3. In some sectors, institutions are increasingly using buying consortia to pool their buying power and obtain low prices. This gives competitive advantage to large suppliers who can make available large volumes of a wide array of products and excludes smaller suppliers with a more narrow range of goods.

4. Continued competition within industries will lead to further efforts to reduce the costs of supplies.

What Does this Mean for Economic Inclusion

The changes in the economy pose challenges and opportunities for minority businesses and for the Boston economy as a whole. The 2000 census shows that more than 50 percent of the city of Boston is now Black, Latino, Asian, or other minority. One of the major questions for the future is "How will the new demography come to be interwoven in the economic fabric of the city, region, and state?" The answer depends in part not only upon a resolve to build upon and/or change the dynamics of the past, but also upon our ability to take note of the present and the current
developments that are creating a future unlike that of the past. In particular, outcomes will be shaped by our ability to understand and appropriately address new issues within the economy and to understand the potential consequences of present and emerging structures on economic opportunity.

The importance of the currently occurring changes in the economy, the structural transition that these changes imply, and the challenges and opportunities that they present can be seen by considering the roles of assets and asset formation. Ultimately, the unifying idea behind various types of assets (financial, structural, intellectual) is that they help to produce desired results. In the world of supply contracts, the most important initial desired result is obtaining a contract. The task faced by businesses seeking supply contracts from other businesses is to present their assets in a way that leads to their selection for the contract. Success in obtaining contracts typically involves more than one type of asset, and may include both product and personal characteristics (for example, product quality, business capital, management ability, entrepreneurial skill, access to information, personal ties, and other factors).

In the presence of racial discrimination, white skin color has also been a business asset—an advantage for those who held that characteristic and a liability for those who did not. The opportunities for minority businesses to obtain contracts have been hampered in some cases by decision makers’ overt desire to contractually interact only with other whites, because of stereotypes held by decision makers, and/or because of lack of familiarity with minority businesses that consciously or unconsciously became interpreted by decision makers as a risk factor.
These dynamics and others associated with race have been important economically, historically, and socially not only because of the direct effects for immediate contracts, but also because obtaining one type of asset often helps to create other assets. For example, obtaining a contract can improve one's ability to leverage financial resources, can help to establish an advantageous reputation, and can provide other forms of competitive advantages for the pursuit of future contracts. This enhancement of competitive position occurs not only as a natural progression of business growth, but also through express efforts of businesses to build upon past successes, since it is a reasonable business goal to seek to maintain one's competitive advantage once it has been obtained.

Thus, asset formation and asset accumulation processes, based upon past outcomes, can result in self-perpetuating economic advantages. These indirect effects of past discrimination have potentially long-term residual effects and can be particularly pernicious. As discrimination has lessened, the lagged effect of past discrimination in various spheres of asset formation has had an impact on the distribution of successful businesses. The residual competitive advantage from past discrimination in the economy takes the form of differences in home ownership and other assets potentially important to business financing, historical performance records showing ability to handle large contracts, experience derived from previous opportunities, inclusion/exclusion in information flows through social networks, access to other forms of social capital such as trust through previous interaction, and other important business assets.

When the overall distribution of advantages and assets is structured along racial lines, the consequences not only present significant long-term barriers to individual minority businesses, but also affect entire communities within the city since the contours of the flow of business activity
have major implications for the flow of income in the city. The diffusion of economic activity through minority communities is one of the major economic challenges of the beginning of this century.

The new developments highlighted in this report constitute an important change in the set of business assets needed for successful competition for supplier contracts with Boston’s economic anchors. They represent an important juncture in the economic life of the city and region. In recent years, a number of organizations, as well as individual corporations, have made efforts to increase economic opportunities for minority businesses by addressing various issues associated with past barriers. These efforts are important and needed. Economic inclusion efforts must involve reducing current discrimination, and also must mean overcoming current lagged effects in the forms in which they have manifested themselves in the past. The danger posed by the issues presented in this report, however, is that if the changes in our economy continue without addressing these new developments and their implications for economic opportunity, then even as important strides are taken to bridge old barriers associated with race, new barriers reflecting past and current divisions and new manifestations of lagged effects will be added.

According to new figures released by the Census Bureau, while Massachusetts firms averaged $963,030 in sales/receipts for the year 1997, the average for African American-owned firms in Massachusetts was only $85,612 (9 percent of the Massachusetts average) and the average for Latino owned firms was $127,530 (13 percent of the Massachusetts average).10

10 For detailed analysis of earlier minority business data for Massachusetts, see Russell Williams, “An Overview of Minority-Owned Businesses in Massachusetts.” Research Report #37, William Monroe Trotter Institute, University of Massachusetts Boston, 1997.
These data highlight the concern about the potential impact of the issues and directions described by our interviewees, if these issues remain unaddressed. Currently, there is a significant digital divide in the country. This divide occurs among households and businesses. According to the Department of Commerce publication “Failing Through the Net, 2000” the gap in rates of Internet access between black and white households grew from an 18.6 percentage point gap in 1998 to a 22.6 percentage point gap in August 2000. Similarly, the gap between whites and Hispanics grew an additional 5.3 percentage points.

Similarly, emphasis on large suppliers operates against minority businesses. Black and Latino businesses are smaller than their Massachusetts counterparts. While the average Massachusetts firm with paid employees had 21 employees, black and Latino firms with paid employees averaged fewer than 7 employees.

On the other hand, the new developments represent new opportunities. The incorporation of purchasing directors in economic anchors’ strategic thinking offers new opportunities to evaluate overall priorities in light of the important links between the supplier network and the socioeconomic environment. The establishment of a new set of relevant assets for contracting provides opportunities for businesses and individuals in the private and public sector to purposefully intercede in this particular aspect of asset formation and to try to limit the replication of past patterns of inequality. The challenge of addressing this issue through the efforts of minority businesses, economic anchors, and other relevant institutions presents opportunities for new meaningful collaboration among institutions within the city.
Meeting the challenge will require action by minority businesses, economic anchors, and others. The author of this report believes that, among other things, it will require:

1. Broadening commitment in public and private sectors to create an economically inclusive city.

2. Creative thinking and directed action by economic anchors to mitigate the effects of mergers on the potential for supply contract participation by small businesses.

3. Resolve and action by minority business owners who will be seeking contracts from economic anchors in the future to ensure that they possess needed technological capabilities.

4. Creating collaborations among businesses, government agencies, and other institutions to overcome any information deficits about business to business (B2B) e-commerce, and any barriers of affordability.

5. Expanding and/or creating pools of expertise within communities of color to enhance the spread of current and future successful practices.

6. Conceptualization by businesses and individuals across the metropolitan area of a future with strong economic activity intertwined with demographic diversity.

**Final Thoughts**

Recent articles in the Harvard Business Review have suggested the importance of corporations’ developing new ways of thinking about their suppliers -- ways that emphasize partnership and mutual long-term benefits. This perspective emphasizes picking suppliers not only for the immediate supplies they can provide, but also for their capabilities with relevance to the corporation’s short and long-range plans for expansion and development. Supplier capability will
be developed along with the corporation in various ways, including training and the use of increasingly sophisticated interactive information technology.

Similarly there is an importance in thinking about partnerships between corporations and communities. Long-range corporate development plans include assumptions about levels of demand for goods and services and the supply of skilled employees. However, neither of these occur in a social vacuum. A community's ability to participate in the trade that corporations depend upon requires an active business substructure of suppliers as well as further substructures of other businesses depending upon flows of income through suppliers. The development of needed skills in an area depends upon the ability of families to invest in the education and training that will match the needs of employers in years to come. The general quality of city life depends in part upon levels of poverty, unemployment, and underemployment.

For these reasons and others, communities are important for corporate long-range development plans. In calling attention to the economy-wide transformation of recent years and its significance for an important aspect of the urban economy, we hope to increase awareness of the importance of the supplier sector of the economy, the economic links that extend from corporations to suppliers, and how those links extend through current and potential local suppliers to communities. We hope to spur further discussion about these links as the economy continues to evolve. Finally, we hope to increase the number of corporations and individuals who possess the willingness and resolve to address issues that can improve those links.