**MNP 2601 Purchasing Management**

**Chapter 2: The task of purchasing and supply management**

Supply management is the process of planning, implementing, evaluating and controlling strategic and operational purchasing Decisions for directing all activities of the purchasing function toward opportunities consistent With the firm’s long-term goals.

**Purchasing and supply management as part of business management**

Executed as an integrated part of the firm’s broader management.

Purchasing and supply planning his style of offence general planning, mainly because the continuous flow of raw materials, materials, components and services is of strategic importance to the enterprise.

The organizational structure of the purchasing and supply function should be aimed mainly at linking into the firm’s overall structure in the most effective way.

The firms P&S function should be compatible with the firm’s organizational structure.

P&S coordination should be ended harmonizing and the lining the activities of the P & S function with those of other business functions.

Control is that in element of management which ensures the activities are executed according to plan.

**Planning for purchasing and supply management**

***The nature of purchasing and supply planning***

P & S planning is the first responsibility of P & S management. At the task can only be executed after the planning task has been completed.

The following general factors headed to what is called the ‘resource crisis’ which has made P & S planning increasingly more crucial over the past two decades:

* Energy crisis
* Scramble for commodities
* Shortages or semi finished products
* Inflation
* Fluctuating exchange rates
* Government control in producer countries

***Levels of P & S planning and objectives***

P & S management can be involved at three levels and the organization:

* Organizational planning – strategic planning
* Functional or tactical planning – middle management level
* Operational planning – lowest level

An important part of P & S planning is the formulation of objectives.

Overall objectives are part of a strategic or long-term objectives. Tactical and operational objectives and should support strategic objectives.

Lower levels of objectives will transform the strategic or long term objectives into more specific feasible ones.

See the table on page 24 of the study guide

***Strategic purchasing and supply planning***

Strategic purchasing and supply planning is planning for the long term and should take place at top management level.

One of the aims of strategic purchasing and supply planning is to plan purchasing and supply pro-actively and move away from reactive purchasing.

The following factors will determine whether the purchasing and supply function can play a proactive or reactive role in the strategic planning process:

* Extent to which the enterprise depends on purchased products, raw materials and services
* Importance that top management attaches to the P & S function.
* Extent of the evolutionary development of the purchasing and supply function within the enterprise
* Ability of the P & S manager to fit a shift in emphasis from tactical to strategic purchasing
* Importance of supplier relations and long term contracts
* Willingness of top management to invest in integrated systems.

Examples of areas for which supply management can develop strategies:

* Assurance of supply strategies
* Cost reduction strategies
* Supply chain support strategies
* Environmental change Strategies
* Competitive edge strategies
* Risk management strategies

See figure 2.1 in the textbook

See page 27 in the study guide.

***Tactical purchasing and supply planning***

Executed at functional or middle management level.

P & S management has a dual role to develop existing and supply strategies as part of the broad strategy of the enterprise at top management level and to implement in the middle management level.

Entails planning the resources required for achieving the objectives and planning the effective application of resources.

For categories of P & S planning at mid-management level can be distinguished:

* *Needs*
* *Purchasing and supply of programme* planning – include planning of the Supply System, a time schedule of deliveries, planning of transport, preparing materials budget for the quantities required, and negotiating contracts with suppliers
* *Planning the purchasing and Supply System* – determining procedures for purchasing activities, planning inventory investment the inventory control system. Important dates include EDI and MRP II
* Extraordinary projects – Purchasing of Capital Equipment, changes to the organizational structure , planning necessitated by large purchasing contracts running for periods of between two and five years.

***Operational purchasing and supply planning***

These objectives represent the implementation of P & S policy and strategy by planning for specific purchasing and supply activities over the short term.

Objectives and operational level was used for each of the above mentioned categories at middle management level.

* *Materials requirement planning -* Entails planning marketing investigation and analyzing and interpreting master production schedules
* *Supply planning* - entails planning negotiation, calculating the most economical order quantities and using supplier sources.
* *Planning of purchasing and Supply System –* means that specific supply activities are allocated to subgroups in the purchasing and supply function. A purchasing and supply menu is compiled, setting out the procedures for P & S activities.
* *Extraordinary projects –* depends on the nature of the project.

**Organizing P & S management**

Due to the growing importance of the purchasing function, the P & S department must be organized in such a way that it links up with the overall organizational structure.

The creation of an effective organizational structure of the P & S function is in threefold process:

* The decision is made about the position of the P & S function in the org structure of the enterprise.
* The internal organizational structure of the P & S function is formulated.
* Management decides on the extent to which all activities relating to the supply of materials should be integrated with other functions in the organization.

***Position of the purchasing and supply function in the enterprises organizational structure***

The position or level of the purchasing and supply function has significant implications for the execution of the P & S function.

It has an influence on the extent to which the P & S function contributes to the overall management of the enterprise.

It is affected by factors such as:

* The extent of the monetary value
* The perceived contribution of P & S to enterprises profits
* Of possibility of increasing their profits
* The variety and nature of materials to be purchased
* Tackle supplier market
* Time based competition
* The size of the enterprise
* Management’s commitment to integration

***Centralized purchasing and supply organizational structure***

When a firm vests the authority for the P & S function in one person or dedicated team.

Centralization has become more widely used because of:

* the availability and efficiency of transport and logistic networks
* new developments such a supply chain management , supply partnering , long term contracts and integrated information systems.

***Decentralized purchasing and supply organizational structure.***

Defined as purchasing by different departments, branches or plants we each ensure he is a measure of autonomy over decision making in respect of P & S.

See the table on page 29 of the study guide

See table 2.2 in the textbook – advantages and disadvantages of centralized and decentralized P & S

***Combined purchasing and supply organisational structure.***

The combined or hybrid approach represents a combination of the centralize and decentralized structure.

In this approach common requirement of different plants, ie equipment and categories of raw materials, are purchased centrally by the head office.

Individual requirements of different plants are produced on a decentralized basis.

***Internal organisational structure of purchasing and supply***

The main advantages of organizing the function by means of internal subdivisions are:

* enables buyers in enterprises to specialize.
* everybody body knows what tasks are allocated to them and other colleagues

***Cross functional teams***

People at lower levels are empowered and included in decision-making.

Important purchasing decisions are also made BAB areas teams consisting of representatives from the purchasing function, quality control, engineering, new product development, marketing, and sometimes even suppliers.

Using cross functional teams has many advantages for a firm:

* different perspectives and expertise of team members
* Responsiveness to user needs
* Increased acceptance by users of the products
* Understanding by other functions of the range of tradeoffs considered in making a final purchase
* Reduced time to solve problems or computer – task
* Increase innovation
* Joint agreements and ownership of decisions among the members
* Enhanced communication between functions and top management
* Teams exiting responsibility for problem correction.

See table 2.3 in the textbook.

**Coordinating purchasing and supply management**

***The nature of purchasing and supply coordination***

The P & S function is an auxiliary or support function providing a specific service to other functions in the organization.

The P & S functions direct contact with the external environment also contributes to the complexities of the P & S coordination.

***Coordination between purchasing and supply and other functional areas.***

Lateral purchasing and supply coordination has mutual advantages for both the purchasing function and other functions in the organization.

Lateral coordination is important because the purchasing and supply function acts in an advisory capacity on aspects relating to the supplier market and in a verifying capacity with quality control

The nature of the relationship between purchasing and supply function and functions of the enterprise contains the potential for conflict.

***Coordination between purchasing and supply and the Supplier System***

Consists of two dimensions:

* Coordination has to be established with the whole Supply System
* Called nation with the activities of the individual suppliers is also important

To particular coordination task of purchasing and supply management is to coordinate the objectives, abilities and activities of each component of the overall supplier system with those of the enterprise and the purchasing and supply function.

The chief coordinating mechanisms available to P & S management are:

* Open communication
* Strategic alliances
* Integrated systems
* Conscious motivation of suppliers
* Standardisation of specifications
* Purchasing documents and purchasing procedures

**Control: performance evaluation of the purchasing and supply function**

The most important overall control mechanism P & S is the process of performance evaluation, which is fundamentally aimed at improving overall performance.

An assessments should be made of the degree of success which supply activities are carried out, after which manage uses this information to improve performance.

Performance evaluation of the material supply activities has both an:

* Objective quantitative dimension
* Subjective qualitative dimension

***Objectives and basic principles of performance evaluation***

Most important objectives for the performance evaluation of the purchasing and supply function of the following:

* Improvement of purchasing and supply performance
* Provision of information to purchasing and supply management
* Motivation and enhancement personnel
* Placing the internal reorganization of purchasing and supply activities on a rational footing
* Establishing an objective basis for comparing the P & S performance between different purchasing and supply divisions in the enterprises and also between different firms.

Within the context of the set objectives, the underlying principles of P & S performance help to paint a clearer picture of the essence of the performance evaluation of the purchasing and supply function. Principles comprise the following:

* Performance evaluation of the purchasing and supply function entails costs –and benefits derived must be weighed up against these costs
* Performance evaluation must make provision for both quantitative and qualitative measures
* Evaluating the performance of the P & S function requires a sound database containing information that covers a wide spectrum of purchasing and supply activities.
* P & S evaluation must be updated continually.
* Performance in the P & S function must be evaluated using several measures.

***Difficulties relating to the performance evaluation of the purchasing and supply function***

Some of the more obvious difficulties of purchasing performance evaluation of the following:

* The P & S function is performed by means of a large number of diverse activities – it is extremely difficult to build up an objectively based overall picture of P & S performance.
* Is difficult to express the performance of the various P & S activities in quantitative terms.
* Is difficult to set quantitative standards for the P & S performance.
* Traditional purchasing objectives are of little practical value in the performance evaluation of the P & S function.
* Purchasing performance is directly influenced by factors external to the function i.e. corporate strategy, market forces

***States in the process of evaluating the purchasing and supply function***

The following states are generally accepted:

* Determining the objectives of P & S
* Determining appraisal factors and criteria for success
* Performing internal audits, self-governance and self-assessment
* Exercising managerial control in response to results.

***Step 1: identify objectives are determine the scope of the P & S function***

Persisted in evaluating performance is that elimination of the scope of the purchasing function in a specific firm and the identification of set objectives for it.

Measuring against objectives or standards is the essence of the any control procedure.

Top management’s view of the objectives and scope of the P & S function must be obtained.

Objectives for evaluation purposes should be approached with circumspection

***Step 2: establishing performance measures and performance indicators for evaluation:***

A decisive step in the successful implementation of performance evaluation.

Establishing performance measures and the contaminant metrics involves the designing of yardstick of practical evaluation of purchasing and supply performance.

By performance measure represents a group of related purchasing activities that jointly provide a picture of a specific aspect of purchasing and supply performance.

Purchasing performance indicators are a series of measurement techniques whereby quantitative values can be determined for specific purchasing and supply activities

Greater emphasis is being placed on measures such as the following:

* Human relations
* Professionalism
* Negotiating ability
* Commodity knowledge
* Ability to cultivate qualified suppliers
* Team-building

They must be three evaluations of measures and norms:

* Level one: P & S management – evaluation of the performance of P & S management on a subjective basis
* Level two: Supply proficiency – relates to performance levels of the function and also to the achievement of P & S objectives. Means that performance evaluation of the supply proficiency level determining the extent to which the purchasing and supply function has achieved the overall objectives.

The most important measures that can be used for performance evaluation at this level are:

* + Pricing proficiency – extent to which the P & S function has allowed purchasing to take place at competitive prices. Matrix there can be vague and put this measure on the following:

(see the textbook with the formula)

* + - *Price variance ratio*
    - *Invoice price variance*
    - *Cash discounts negotiated*
  + Supplier performance – the selection and development of the Supply System are taken to be the primary tasks of the purchasing and supply function. Examples of performance indicators that could give an indication of supplier performance include:
    - *Rejection ratio*
    - *Supplier turnover*
  + Materials flow – gives an indication of the degree of proficiency of the purchasing function in allowing a continuous accurate and prompt flow of materials between supply and the firm.

Examples of matrix include:

* + - *Promptness factor*
    - *Outstanding orders*

Some materials supplier performance measures include:

* inventory holding

* production planning and control
* material handling
* Quality – and performance to quality requirements is a key proficiency measure. Examples of the most important norms include:
  + - *Quality certification*
    - *Quality delivered*
* *Level three: supply efficiency. Includes:* 
  + *Cost savings – Attempts to depict how efficiently the P & S function utilizes Financial Resources.*

*Examples include:*

* + - *Cost avoidance ratio*
    - *Inflation index*
    - *Quantity discount ratio*
* *Workload – Concerned with the performance of the P & S personnel. Examples include:* 
  + - *Input ratio*
    - *Expenditure ratio*
* *Administrative performance – related to the administrative budget for the P & S function and is closely linked to the workload as a performance measure.*

*One of the best ways to measure administrative issues is through benchmarking*

*Permitted lay down for administrative performance also chiefly reflects the relationship between the cost and some or other element of purchasing function outputs:*

* + - *Purchasing cost ratio*
    - *Cost per order*

*All three performance measures at this level are particularly sensitive to these influences and can give rise to a distorted image of actual purchasing performance if both images and the performance indicators are not carefully selected.*

***Step 3: measurement of the actual performance***

The availability of information from an established information system considerably facilitates the task of performance evaluation.

For those aspects of purchasing performance for which quantitative objectives can be readily set the MS them into the actual performance consists of comparing actual performance with the set quantitative objectives.

There is a difference in the measurements are the actual performance at three levels

At the purchasing and supply management level, evaluation is mainly subjective.

Of the levels of P & S proficiency and P & S efficiency more objectives and quantitative methods are used

***Step 4: evaluation of actual performance***

Evaluation of actual performances is closely interlinked with the measurement of actual performance.

Attention must be given to those measures and metrics for which actual performance does not measure up to the planned or expected performance.

One can adopt four main approaches when evaluating the actual performance of the P & S function:

* *Historical approach – drawing a comparison between present P & S performance and preceding periods*
* *Budget objectives*
* *Quantitative objectives*
* *Benchmarking – gives P & S management a picture of how the function is performing compared to other companies.*

***Step 5: reporting***

The final step in the evaluation process of the P & S function. Report aims are providing information about those aspects of the P & S function which is unsatisfactory.

As performance evaluation is on-going feedback of results should be continuous.