**MNP 2601 Purchasing Management**

**Chapter 4: Purchasing and supply policies and strategies**

Strategic sourcing pertains to all issues of strategic importance in the supply of materials and services to modern organizations

Can also be regarded as a strategic management process whereby commodities and suppliers are analysed and relationships are formed and managed according to best practice and appropriate strategies.

**The process of strategic sourcing**

Consists of a process containing the following steps:

* Building the team
* Conducting market research
* Developing a strategy
* Negotiating a contract
* Managing supplier relationships

See figure 4.1 on Page 60 of the text book

***Build the team***

The strategic sourcing process starts with the building of a multi-functional team who will act a category teams for the sourcing of certain category items.

A team may consist of a purchasing manager, an operations manager and information systems manager etc

***Conduct market research***

Conduct market research on the suppliers.

Make a spend analysis of the total expenditure for each commodity and supplier and the spending on the commodity as a percentage of total spending.

Data should be connected and transformed into a comprehensible format to use strategy development and decisions.

***Develop a strategy***

The information gathered must be structured into a format which makes it possible for the team to develop a strategy for Similar commodities.

The portfolio analysis matrix or strategic sourcing matrix can be applied to bring structure. With this matrix the total spending is divided into different categories according to the risks involved in the supply of the commodity, The number of suppliers in the market and the amount spent on a commodity.

The total spending can be divided into the categories:

* Routine
* Leverage
* Bottle neck
* Critical

See figure 4.2 on page 61 of the textbook

Routine items - in arms length relationship is applicable. Decisions are made on lower levels and without much effort to search for suppliers.

Leverage items – or large amount is spent the supply risk is low.i.e. computer hardware

Bottle neck items – amount spent is no better risks are high because:

* substitution of products is difficult
* specific missions and manufacturing are complex
* The commodity has a big impact on the operations
* The market is monopolistic with high barriers for competition
* The situation is geographically and politically complex

Critical items – large amounts are spent and the risks of availability are high due to difficulty in substitution.

***Negotiate a contract***

The contract is negotiated with the identified suppliers and the strategy is implemented in terms of time lines, resources and accountability.

***Manage supplier relationships***

The basis for managing a relationship should be the performance evaluation of suppliers.

**Outsourcing: to make or buy**

Traditionally, large organizations tend to choose the make option. This lead to backward integration, large organizations and ownership of a large group of manufacturing plants. Purchases involved mainly raw materials that were processed in the enterprise.

Outsourcing is described as the process of purchasing goods and services on specification from an external supplier.

It can involve the transfer of an entire business function to supplier or may lead to the transfer of some activities associated with the function.

Co-sourcing consists of a partial outsourcing of functions and activities.

Outsourcing can involve the transfer of both people and physical assets to the supplier. A term often used in the context of outsourcing and insourcing is vertical integration or Vertical disintegration (Concerned with the decision on whether to perform an activity internally or source it from outside)

In sourcing is vertical disintegration

Backward Disintegration refers to activities on the supply side and forward disintegration to the distribution side of an organizations supply chain.

Major characteristics of outsourcing are:

* Activities that were initially performed in house being transferred to an external party
* Assets going over to that external party
* Existence of an extended relationship between the parties over a longer period
* Exposure of the buyer to both cost and risk profile transfer

Certain trends in the business world made outsourcing popular:

* Efforts to make enterprises leaner
* Narrowing the supply base to limited number of suppliers
* Pressure to be Internationally competitive
* Organization specializing in a limited number of products and technologies
* Emphasis on quality, delivery times and technology
* Pressure to get to technology developments
* And lack of skills, knowledge or capacity
* Pressure on organisations to deliver excellent customer service

***Rationale for outsourcing***

Tactical reasons are to:

* reduce operating and control costs
* three up internal resources
* Receive important cash infusion
* Improve performance

Strategic reasons include:

* Improve company focused
* Maintain access to world class capabilities
* Gain access to resources that are not available internally
* Accelerate reengineering benefits
* Improve customer satisfaction
* Increase flexibility and risks

Outsourcing may have considerable economic and strategic advantages for the enterprise.

It can bring about cost savings if the service provider can offer the product or service at a lower cost of ownership.

Outsourcing contractors as can enlarge the production operating capacity of the enterprise, helping to save large amounts of capital for additional production or operation facilities.

Outsourcing may also assist the organization to respond to changes in market demand quickly.

Disadvantages of outsourcing include:

* Outsourcing contractors or service providers become dependent on the enterprise – captive supplier
* An enterprise can become over involved in the development of contractors or service providers.
* Loss of control and skills
* Loss of service provider focus
* Lack of clarity – If the particulars of the responsibilities are not clearly prescribed.
* Lack of cost control
* Ineffective management – outsource service provider may not be efficient, effective all capable of performing well
* Loss of confidentiality – service provided becomes an extension of the organization and has access to information.
* Double outsourcing – where an outsourcing contractor outsources the service to another provider.

**The outsourcing decision process**

The outsourcing decision requires a wide variety of knowledge and technical skills ranging from strategic thinking to indepth cost analysis.

The Outsourcing decision process may consist of the following phases:

* Assessing the causes for outsourcing
* Defining core activities
* Analyzing the strategic position
* Considering non-cost factors and making a decision
* Conducting a total cost analysis of core activities
* Analyzing the relationship

See figure 4.3 on page 65 of the textbook

***Phase one: Assess the causes for outsourcing***

Often triggered by technology and demand trends including:

* New product development – be sure to consider the stability of the technology and its lifecycle
* Strategy development – driven by the business strategy development process
* Poor internal or external performance and competencies – unsatisfactory performance or incompetence
* Changing demand patterns – market changes may need a shift in production or service provision
* Shifting technology life cycle – outsourcing effectively shifts the risk to competent, flexible external sources that specialize in technology.

***Phase two: define core activities and competencies***

In this phase a connectivity importance analysis is competed. McIvor 2005 suggests use of the critical success factor method (CFM)

The process of identifying core competencies and activities should be carried out by top management with inputs from consultants and teams representing all functions.

Organisations prefer to keep core activities inside the organization and outsource all non-core activities.

***Phase three: strategic analysis***

The major strength that give the organization a competitive advantage should be identified.

The competitive advantage maybe the way the organization leverages its costs or differentiates its product.

Strategic analysis may be executed through a swot analysis, value chain analysis and capability analysis

The benefits of carrying out this analysis are:

* the organization can focus resources on the activities where it can achieve preeminence
* Activities for which the company has no critical strategic need should be outsourced

***Phase four: consider the non cost factors and make a decision***

That outsourcing team may decide to perform an activity inside or may go with outsourcing.

Non cost factors should be highlighted:

* Control of production/service and quality – organization must ensure that the critical product or service is available
* Design secrecy
* Unreliable suppliers
* Supplier specialized knowledge and research
* Volume of requirements
* Availability of facilities
* Workforce stability

***Phase five: conduct of total cost analysis of core activities***

And effort is made to measure all the costs involved in the interim a provision and external sourcing of the activity.

Tenders can be requested from the top suppliers of the product or service. The second stage concerns determining the cost of carrying out the activity internally. The availability of an activity based costing (ABC) management system will use the formidable task of identifying cost in the organization.

What costs should be included in and insourcing/outsourcing decision is open to debate.

Table 4.1 on page 67 of the textbook:

*The main cost elements that should be included in the insourcing/outsourcing analysis:*

If the organization is more competent in performing an activity than any other external source management might decide to:

* Keep the activity in house maintaining any current advantage
* Outsource the activity to the most competent external source if there is no certainty that your organization will be able to sustain its competency

If external sources are more competent at performing the activity than internal sources top management may decide to:

* Invest in resources to enable the organization to improve the performance of the activity internally
* Outsource core activity that does not give any competitive advantage

***Phase six: relationship analysis***

The relationship between the two parties to an outsourcing agreement may take many forms. The relationship will depend on:

* The technical, management and financial capacity of the two parties
* The type of product or service
* Supplier market conditions
* Competitiveness of the country’s economy
* The motives of the organization

The support which the organization gives the service provider may vary from:

* No support
* Assistance with the establishment of a service provider
* Financial assistance
* Provision of skilled labour
* Technological assistance
* Training and management of workers
* Assistance with quality control
* Purchase of raw materials

Larger enterprises that outsource simple production or service tasks to unsophisticated businesses will often have to offer greater support to the service provider in the form of training of workers, creation of the infrastructure and management.

The more critical the product or service in terms of risks in the supplier market and technological advancement, the longer term of the contract will be.

An SLA will usually form part of the contract with the supplier of the outsource product or service .

**Supplier policies and strategies**

***Local, national or international suppliers***

Various options have advantages and disadvantages:

Overseas suppliers may have advantages for SA enterprises:

* Advanced technical expertise
* Been quality
* Lower cost you to lower labour costs
* A larger production capacity in
* Large or product range

Disadvantages of the overseas suppliers may include:

* Higher transport costs
* Longer lead times
* More administration
* Exchange rate and political risks
* Cultural factors
* Possible inappropriate use of workers i.e. slave labour

Local or nearby sources of supply have advantages including :

* Lower transport costs
* Shorter lead times
* Small inventories
* Improve communication
* Express orders being easier to expedite
* More reliable service
* Better personal relationships with suppliers
* Support of local business

Advantages of larger national local suppliers:

* Lower prices due to mass production
* Technical support in the former intensive research and development
* Continuity of supply as big national suppliers are in a strong financial position and hold more stock
* Improved service from local branches and depots.

***Purchasing from a distributor or manufacturer***

Include the following advantages:

* Distributors have specialized product knowledge
* Purchasing enterprise has a wider choice of style, quantity, colour, packaging and finish
* Shorter lead times and the after sales service due to better locality
* Better Marketing Services i.e. Transport, storage, reordering, financing
* System contracts can be entered into to reduce administration and stockholding

***Supply base optimization: one supplier or more***

The process of identifying how many and which suppliers will be maintained

Effective supplier management and development begins with determining the right number of suppliers an organization should maintain.

The concentration of purchasers from one or limited number of suppliers may be beneficial to the enterprise under certain circumstances:

* Were successful relationship exists
* With the supplier his patent rights or a unique process
* With the supplier offers outstanding quality
* We orders are too small to justify more than one supplier
* When bigger discounts or lower transport cost make it worthwhile
* Where the enterprise has a stockless or JIT system.
* When electronic data interchange is used
* When partnerships with suppliers are the obvious supply strategy
* When a supply management approach is followed in the firm.

Using more than one supplier for the same item or service may be to the enterprises advantages when:

* The enterprises buying strategic or important projects
* When one supplier specializes in one product or service and another gives support only
* Using small enterprises to be involved in community development
* When one supplier does not have sufficient capacity to supply the enterprises current or future needs

***Size of suppliers***

Smaller businesses often supplier to the local market only. They are characterized by flexibility, speed and availability but usually at a higher price.

Larger enterprises are suitable for large volumes but usually of lower quality.

***Supplier development***

There are three main ways in which an enterprise may become involved in the development of suppliers:

* Purchasing from disadvantaged suppliers – BEE
* Taking action when a product of services not available – produce product themselves
* Performance appraisal of suppliers

***Reciprocity***

Meaning: *buy from you because you buy from me*

***The decision to make or buy***

A larger enterprises usually choose the make option. However the new management focus is on the enterprises main mission or core business.

The following circumstances will favour buying requirements or outsourcing services:

* If the enterprise has a strong purchasing corps
* When there are inadequate facilities or better investment possibilities
* When the operational staff knowledge and skills are inadequate
* When the demand for product and services is a relatively small
* When it’s cheaper to buy than to make

The following circumstances are more favourable for making the product or insourcing the service:

* When it costs the enterprise less to produce a product or service
* When there are no or few reliable suppliers
* When there is capacity available for use
* When the enterprises quality requirements are very stringent
* For competitive, political or social and environmental reasons
* For emotional reasons

***Captive suppliers***

The supplier becomes dependent on the enterprise

***Environmental protection***

Purchasing should be made according to the following three main aspects concerning the environment:

* Does the suppliers mission support policies and measures to protect the environment during manufacturing of products
* Are the products environmentally friendly themselves
* Are the right products and quantities produced to prevent obsolescence and waste?