**MNP 2601 Purchasing Management**

**Chapter 6: Sustainable purchasing and supply management**

**Corporate governance and purchasing and supply management**

The King report boats on the principle of King II by emphasizing sustainability, and providing a list of best practice principles.

King III provides guidance to all corporate entities on serious governance related aspects including:

* Ethical leadership and corporate citizenship
* Boards and directors
* Audit committee’s
* The governance of risks
* The governance of information technology
* Compliance with laws, rules, codes and standards
* Internal audit
* Governing stakeholder relationship
* Integrated reporting and disclosure

Directors have an economic accountability to shareholders and an obligation to all stakeholders to ensure that the company’s resources are utilized service to ensure the continuing viability of the business.

This involves:

* environmental sustainability,
* social responsibility,
* respect for human rights
* Effective management of stakeholder relationships

King three – economic value of the company is not based on the balance sheet alone

In purchasing situations, P & S personnel must always:

* act professionally in the interests of the organization and stakeholders
* be free and honest and awarding of contracts
* Have an intimate knowledge of the product or service they purchase
* Having intimate knowledge of the supplier market and market conditions
* Keep up to date with the newest developments in the P & S field

For corporate governance and financial reporting, specific attention must be given to possible problem areas such as long-term purchasing agreements, electronic communication with suppliers, supply management, inventory control, write-offs and risk management.

**Corporate social responsibilities of P & S management**

P & S management has an economic responsibility to shareholders.

P & S is expected to comply with legal obligations and must also observe ethical responsibilities.

P & S responsibilities can be defined as meeting the discretion responsibilities expected by society. These encompass activities relating to:

* Community – buying from local suppliers, donate into local development campaigns.
* Diversity – search for and purchase from previously disadvantaged groups
* Environment – using life cycle analysis to evaluate the environmental impact of its products and packaging. Encouraging other suppliers to commit to waste reduction goals & environmentally friendly practices
* Ethics – abiding by the organisations code of conduct
* Financial responsibility – following applicable financial standards and requirements and applying sound financial practices
* Human rights – respecting the constitution of South Africa and ensuring the fair treatment of workers and workers conditions
* Safety – promoting a safe environment for each employee in the supply chain

**Ethical aspects in purchasing and supply management**

***Business ethics***

The set of moral principles or rules of conduct that guide our behavior in business.

The key requirements stipulated by the King III report are regarded as follows:

* The board should ensure that the company is a responsible corporate citizen
* Leadership should be effective and based on an ethical foundation
* The board should ensure that management cultivates ethical conduct and the creation of an ethical risk profile and the establishment of a code of conduct.
* The assurance of the companies ethics performance supported by an assurance statement

Business ethics and ethical conduct starts with top management.

***Purchasing and supply ethics and ethical conduct***

Purchasing ethics are based on business ethical principles.

Business people, managers and individuals are not as concerned about ethical conduct in any other area or function of the enterprise as much as in purchasing and supply for the following reasons:

* Purchasers have power over large sums of money
* Purchasers may have the greatest say in terms of which supplier will receive an order
* A purchaser is exposed to more unethical temptations than any other employee
* Unethical action by purchasers influences relations with suppliers
* Temptations influence a purchasers objectivity and rational thinking

Sales representatives are frequently less mindful of ethical conduct.

***Areas of unethical conduct among purchasers***

Personal favours include gifts, money in the form of kickbacks and even bribes. There are more subtle areas in which the purchaser can consciously or unconsciously act unethically:

* A purchaser may have interests in supplier, and may put their own interests before those of an employer.
* Loyalty of purchasers or fear of retaliation from superiors may give rise to unethical behavior.
* An enterprises purchasing power can also be misused if purchasers placed orders for themselves and their friends
* Withholding important information from a supplier may be unethical if the suppliers position is harmed in a competing transaction.
* Information on suppliers obtained from written quotations, tenders or sales representatives should be treated confidentially.
* The setting of specifications by the users or purchasers to suit one specific supplier to cut out competition is unethical.
* Disclosure of confidential information on the purchasers own organization is unethical.

***Ethical code of conduct***

The first and most effective measure against unethical behavior.

The policy document on ethical behavior should contain information such as

* the policy on the acceptance of gifts
* meals are included trips
* Dealing with sales representatives
* Ending quotations and tenders
* Dealing with confidential information
* Disseminating information
* Behavior during negotiations
* Policy pertaining to a supplier in which the purchaser or members of management have an interest
* Using an organizations equipment in time for personal work
* Direct purchases by other sections and managers

The ethical code of conduct should be made known to every purchaser, manager and member of staff.

Training and education on ethical conduct should be given to management and personnel.

All suppliers should be supplied with a printed copy of the policy.

The benefits of the ethical codes are as follows:

* They provide a basis for working together, which requires that people treat each other with respect
* Set boundaries for what constitutes ethical behavior
* They provide a safe environment because everybody knows what is expected of them.
* They provide a commonly held seat of guidelines which binds people together.

***Fraud in purchasing and supply management***

The basic distinction between fraud and error is that of the intention.

A person committing an error does not do so knowingly – periods of accidental.

Fraud is intentional.

**Green supply chain management**

***From green purchasing two green supply chain management***

Environmental or green purchasing is the integration of environmental considerations into purchasing policies, programmes and actions.

Objectives of green purchasing is to facilitate recycling, reuse and resource reduction.

Purchasing can contribute to environmental performance in a number of ways:

* Buying packaging materials that can be more easily recycled
* Participating in the design stage and suggesting alternative sources of supply
* Asking upstream members of the supply chain to commit to waste reduction goals
* Using early supplier design involvement
* Selecting suppliers based on environmental criteria
* Evaluation supplier environmental performance

Purchasing plays an important role in communicating green concept and efforts to other organisations in the supply chain

Green supply chain management: integrating environmental thinking in to supply chain management – encompasses a broader range of practices from green purchasing to integrated supply chains.

Table 6.1 on page 96 of the textbook - greening opportunities throughout the supply chain.

**Risks and risk management in purchasing and supply**

***Risk and uncertainty***

In the business world, organizations are operating in an environment which constantly changes.

Uncertainty increases as planning stretches further into the future.

Uncertainty about the future manifests itself as the risk that the realized financial results would deviate from that which was anticipated.

The perceived level of uncertainty depends on information that an individual can use to evaluate the likelihood of the outcomes and the individual’s ability to evaluate this information.

Uncertainty consists of the following:

* Uncertainty about whether an event will take place.
* If the event does occur what the outcome will be.

The degree of uncertainty surrounding the event determines the level of risk.

Risk in a corporate environment can be subdivided into four categories:

* Core business risk
* Incidental business risk
* Operational risk
* External downside risk

See figure 6.1 on page 97 of the textbook

***The classification of risks inherent in purchasing and supply management***

Purchasing and supply risks can be found in all of the risk groupings indicated.

*Speculative purchasing and supply management risks*

Those risks that offer a chance of gain or loss

*Core business risks in P & S*

Include all the activities, decisions and events which impact directly on the operating profit of an organization. These risks are inherent to the main business of the organization.

The cause fluctuations in the operating profit of the company and eventually also in the earnings of the ordinary shareholder.

*Incidental business risks in P & S*

Risks that arise naturally from the activities of the business. They do not form part of the main business of the enterprise.

These risks are many financial and can generally be subdivided into the following categories:

* Interest rate risk – risk of having to pay more for debt due to changes in market interest rates
* Liquidity risk – risk of being unable to pay suppliers when required
* Currency risk – the possible impact which fluctuations in exchange rates may have.

*Event risks in P & S management*

Include only the possibility of loss was no chance of gain i.e Incoming goods damage during transportation.

These risks are usually referred to as insurable losses as the financial consequences of these losses may be transferred to an insurance company.

Specific event risk categories include:

* External downside risks
* Operational risks

***External downside risks***

Refer to those external factors that could affect the enterprise negatively i.e. natural disasters, robberies, hijackings etc.

Some examples include:

* External suppliers not delivering on delivery date
* Physical security risks
* Litigation risks
* Natural disaster risks
* Labour action risks
* Government regulations pertaining to purchasing

***Operational risks impacting on purchasing and supply management***

Operational risk is the exposure of an organization to losses resulting from the internal failures or shortcomings of people, processes and systems.

*People*

People risks continue to be the major contributing factor in many dramatic failures. Some of these risks include:

* Inexperienced, incompetent, unsuitable , negligent or maverick staff
* Human error
* A working culture that creates low morale, high staff turnover, poor concentration
* Unethical conduct and theft
* Unauthorised and/or ill informed decision making
* The inability to work in a group, and poor human relations

*Processes*

The risk of the P & S processes being insufficient and causing inefficiency and an unexpected losses

*Systems*

Risks resulting from system failures based upon the dependency of P & S on technology

New technologies often have implications of complexity and uncertainty. The newer the technology, the greater the risk that it may not perform as expected.

The following are examples of system risks:

* Systems failures
* Security breaches
* Implementation failure
* Insufficient systems capacity
* Poor data integrity

**Identification of P & S management risks**

Any unplanned events that may occur during the acquisition, delivery or use of the goods and services which can negatively affect the organizations ability to serve its own customers can be regarded as risks.

A radical example of the results of supply failure would be shutdown of production lines due to the lack of incoming materials.

Purchasing practices such as supplier relationship management, so classification and quality management programmes can manage supply risk by reducing the likelihood of detrimental event.

The purchasing and supply process also includes inventory management and the internal distribution of goods and services to operational sections.

***Wrong or inadequate specification***

May either result in the delay in obtaining the required goods or services or in the supply of the wrong goods or services

The loss the purchasing organization suffers as a direct result from procuring unusable goods or services is directly proportional to the monetary value of such goods or service.

***Requisitions received late***

Result in reactive procurement actions which may have a detrimental effect on supplier selection, pricing and quality

***Internal and/or external fraud***

The occurrence of unethical conduct, corruption and fraud in the sourcing supplier selection, invoicing and fulfillment function is real.

***Lack of suppliers***

Refers to situations where monopolies or oligopolys exist.

Monopolistic situations are important from two perspectives:

* Dealing with monopolistic suppliers carries the risk that the suppliers may integrate forward and start competing directly
* Any Financial instability in the monopolistic supplier may be a risk to the purchasing organization

Oligopoly situations normally hold the risk that no better quality or price can be negotiated by the purchasing organization.

Study the table 6.2 on page 101 of the textbook

***Pricing***

Increase in pricing could render the product or service of the purchasing organization too high to sell competitively.

Increases in input costs also have a negative effect on the cash flow positions of purchasing organisations

***Quality***

Quality failures can system from

* the failure of suppliers to maintain Capital Equipment,
* lack of supplier training in quality principles and techniques
* damage that occurs in transit

***Continued availability***

Supply risk becomes prevalent whe a buyer – supplier relationship is formed and the purchasing organization has some form of reliance on the supplier.

***Quantities and lead times***

A supplier may not have extra equipment, available employees or the ability to obtain necessary inputs to handle sudden increases in demand

***Technological changes***

Suppliers may not keep up with technological advances in the manufacturing processes.

If the inputs used by other suppliers in the manufacturing process are less sophisticated than those of competitive suppliers it may impair the comparative functioning of the products.

***Agreed procedures for inspections and returns to supplier***

Every agreement with suppliers holds the risk of quality discrepancies.

It’s important that procedures for the inspection of products received from suppliers be established when the agreement is intended to. Also applies for return criteria.

***Internally errors***

The most common risks are:

* wrong or incomplete documentation
* products not inspected or thoroughly checked on receipt
* following the wrong procedures

I***nformation systems and processes***

Inventory management requires well developed information systems and processes to facilitate:

* the timeous ordering of products from suppliers,
* to prevent or detect inventory losses
* monitor and control the movement of inventory to different parts of the supply chain in the org.

Malfunctioning information systems can lead to inventory shortages and internal distribution problems.

***Disasters***

Floods, fires etc can damage or even destroy the inventory of the purchasing organization.

**Options in managing risks**

Includes:

* risk avoidance – the best method of handling a risk is trying to avoid it entirely
* Risk assumption – the consequences of the loss will be borne by the party exposed to the chance of loss. Typically applies to minor infrequent losses.
* Risk elimination – introduces standards, procedures and actions necessary to eliminate risk
* Risk reduction – reducing the likelihood of occurrence of loss and its severity
* Risk transfer – risks are transferred to another party but not insurance. The risk itself is transferred to a third party ie a lease agreement.

**Pro-actively managing purchasing and supply risks**

To specific techniques to manage supply Risk pro-actively:

* Behavior based management techniques
* Buffer oriented techniques

***Behavior based management techniques***

Addresses supplier processes rather than simple outcomes. Suppliers are evaluated on the behaviors, which then have an effect on outcomes.

The following management techniques serve to align goals of suppliers with those of the purchasing organization:

* supplier certification – suppliers who consistently meets predetermined quality, cost, delivery , financial and volume objectives can be certified.
* Implementation of quality management programmes – implemented in the suppliers facilities and improve the abilities and activities of the supplier to satisfy the quality needs and expectations of the purchasing organization.
* Target costing –requires discussions and negotiations between suppliers and purchasing organization
* Supplier development – purchasing organization must actively improve the capabilities and performance of suppliers to ensure they meet the short and long term supplier needs.

Supplier development includes:

* + Creating and maintaining a network of competent suppliers
  + Reducing costs
  + Upgrading suppliers technical, quality and delivery capabilities

The above can be achieved by:

* Provided feedback of supplier performance
* Raising performance expectations
* Educating and training supplier personnel
* Recognizing suppliers
* Placing engineering or other personnel from the purchasing organization on the suppliers premises
* Directly investing in capital in a supplier

***Buffer oriented techniques***

Buffers are outcomes based ways of dealing with risk. Purchasing organizations use buffers to reduce the detrimental effects of supply risk events rather than reducing the likelihood of a detrimental event . Inventory serves as a buffer for product and availability.

* Internal buffer inventory – supply risk can be reduced by holding additional inventory for contingencies
* Supply inventory – uncertainty regarding delivery of materials from suppliers can be eliminated by requiring suppliers to always hold sufficient safety inventory
* Multiple sourcing – using multiple sources of supply a reduces the risk of supply disruptions. It also competitive

***Contingency plans***

Its important for purchasing organisations to establish contingency plans which could be activated should an expected supplier and inventory risks occur.

A five step supply chain contingency plan can be easily developed.

* Step 1: define critical materials and services
* Step 2: identify critical materials and services and their suppliers
* Step 3: perform a risk assessment of the identified suppliers
* Step 4:
* Step 5: