**MNP 2601 Purchasing Management**

**Chapter 1**

The purchasing and supply function works towards common goal of maximizing efficiency and providing maximum value to the end customer over an organization.

Charles Dominik 2008: purchasing management has been elevated to a more significant consideration of top level business executives. The top 10 include:

* Change 10 – Technology proliferated
* Change 9 – center led procurement arrived
* Change 8 – Purchasing grabbed more spend
* Change 7 – Social responsibility became a top priority
* Change 6 – Measurement was mandated
* Change 5 – Strategic sourcing went DIY
* Change 4 – Supply roles expand
* Change 3 – Global sourcing went mainstream
* Change 2 – The chief procurement officer position was adopted
* Change 1 – The supply chain was recognized

Purchasing for business enterprises is inherent to practically all forms of business and has been a feature of all businesses for centuries.

Purchasing is not equally important for all types of business enterprise

Butter & Linse: over the past 25 years the vaule of industrial and commercial purchasing changed from one of simply buying goods and services to overseeing seeing an integrated set of management functions.

Gundlach 2006: the emphasizing coordination, the focus in purchasing moved away from transaction management to relationship management – relationships internal and the enterprise as well as externally with the many stakeholders that are involved in the narrow goods.

**Unravelling the terminology confusion**

The role of purchasing management function has changed from an admin activity, involving a simple transferal of goods, to an independent managerial function known as supply management which acknowledges the continuous interaction between variables to efficiently we realize the firm’s mission and objectives.

The purchasing function is managed with an integrated management approach known as supply chain management. All supply and buying organizations involved in the process of putting a product on the market, for raw materials to final product are perceived as a unified entity.

In this journey of recognition there are myriad of purchasing and supply terms, and different concepts that have been used incorrectly or interchangeably.

The traditional purchasing function developed into a broader concept known as supply management. Supply management in turn was absorbed into a management philosophy known as supply chain management.

***Purchasing and strategic purchasing***

Purchasing refers to the systematic process of deciding what, when and how much to purchase, the act of purchasing it and the process of ensuring that what is required is received on time in the quantity and quality specified.

Above definition clearly emphasizes the classical approach to the purchasing function.

Purchasing function: the objective is ensuring the continuous flow products and services at the most advantageous conditions for the firm, including the lowest total cost of ownership.

Strategic purchasing: the process of planning, implementing, evaluating and controlling strategic and operating decisions for directing or activities of the purchasing function toward opportunities consistent with the firm’s capabilities to achieve its long-term goals

Strategic purchasing changes the focus of purchasing from a purely functional perspective to one that takes the long-term goals of the firm as a whole into consideration in decisions thereby, in a very real sense, contributing to the future direction that the firm will take.

***Supply management***

The identification, acquisition, access, positioning and management of resources and related capabilities an organization needs or potentially needs in the attainment of its strategic objectives.

Additional characteristics of supply managements include:

* Supply management has a more strategic focus than purchasing
* Supply management is clearly focused on the attainment of the overall organizational goals
* Supply management maintains a systems approach to the acquisition of materials and services, thereby involving other functional areas as well.
* Supply management is a progressive approach to managing the supply base whereby suppliers are regarded as extensions of the buying firm and where they are involved in the strategic level in and long-term relationship closely resembling a partnership.

Purchasing is the foundation of supply management. Supply management is still a function of the enterprise since it includes the typical activities of purchasing, but at the same time it has an broader more long-term focus.

***Supply chain management***

SCM encompasses the planning and management of all activities involved in sourcing and procurement, Conversion, and all logistics management activities.

That also includes coordination and collaboration with channel partners, which can be suppliers, intermediaries, third party service providers and customers. Supply chain management integrates supply and demand management within and across companies.

SCM is not a particular function of an enterprise such a supply management and marketing. It is cross function because it involves many functions.

The supply chain is strongly focused on the customer.

***Logistics management***

The part of SCM that plans, implements and controls the efficient, effective forward and reverse flow in storage of goods services and related information between the point of origin and point of consumption in order to meet customers’ requirements.

Important activities included in logistics management are:

* traffic and transportation
* inventory management
* Packaging and handling
* Warehousing
* The processing of returned goods.
* Customer service

Logistics is therefore strongly focused on the physical flow material goods and services, with a strong emphasis integrating all these activities so that the total cost in the logistics system is minimized.

**Objectives of purchasing and supply management**

The objectives of a business enterprise should always be focused on the profitable satisfaction of customers’ needs.

If the purchasing and supply function is performed efficiently and effectively, it Serves the fundamental objective of the firm – To ensure the highest possible return on the capital invested by the firm.

The objectives of purchasing and supply management also evolved as the global business environment changed and firms had to adjust to more competitive circumstances.

The following objectives are the core of most purchasing and supply functions:

* Supply the organization with the flow of materials and services that meet its current and Future needs
* Manage the supply base so that adequate suppliers are available for the current and future requirements
* Foster inter functional relationships by contributing to multi functional teams and providing outstanding customer service
* Maintain an optimum balance of inventory to ensure the desired level of customer service while minimizing costs associated with service levels
* Maintain and develop the quality of purchased products and services.
* Contributing to the development of overall business strategies by providing strategic supply inputs
* Ensuring that a timely, cost effective and comprehensive information system is in place that will form the basis of all internal decisions

**The importance of the purchasing and supply function for business**

***Reasons for the increasing importance of the purchasing function***

The role of the purchasing function in an organization is influenced by various factors:

* Globalization of world trade and its impact on competitive advantage
* The adjustment of organizational structures to become more internationally oriented
* Rapid developments in information technology – Supplies sources, Market trends & availability of materials
* Increased supply risks – I.e. energy crisis, Local wars
* Increasingly stringent quality specifications and control
* Constant rises in inventory costs
* Recycling material and conserving environment

See activity 1.3 on page 10 of the study guide

**The importance of the purchasing function was successful business operations**

The importance of the purchasing function and effective purchasing and supply management of successful business operations must necessarily be related to profits in return on investment (ROI).

It is necessary to focus on important influence that more efficient purchasing can have on the following three key the business areas:

* *The profit leverage effect*

Represents the main part of an enterprises total expenditure. Explains how a small percentage of saving in purchase price may develop into a relatively large percentage increase in the organizations profit.

See the section in a textbook for a further explanation and formula

* *The turnover/total cost balance*

The impact the supply management has on the net income of the firm by balancing the income from turnover with the cost of inputs the required to generate turnover

The two major elements responsible for a high and it income:

* + Increase in turnover (sales)
  + Lower total cost

Factors influencing increased sales:

* + Improved customer lead time – reduce lead time to the customer by improving supplier relations. Maintain high inventory levels or reduce cycle times from design stage to finished product.
  + Flexibility – increase sales if the firm can adapt quickly to changes in customer demand.
  + Improved quality – customer develops a preference for the firm’s product.
  + Innovation

Factors contributing to lower total cost:

* + Lower inventory cost can be achieved by maintaining lower average inventory levels which in turn can result from reduced supply lead times and lower prices.

Lower inventory may lengthen the lead time to customers thereby exerting a negative influence on improved sales

* + Entering into long term contracts or even partnerships with suppliers can substantially reduce the price of products and services. May make the firm less flexible.
  + Quality costs can be substantially reduced by working with suppliers on joint total quality management programmes and zero defect programmes.
  + Supply management is a major source of innovations for the firm – requires the best IT available.

***The influence of more efficient purchasing on the return on investment***

ROI rests on two pillars:

* Profit margin
* Asset turnover – how efficiently the assets have been employed.

Return on investment = profit margin x turnover of assets = total income of the enterprise x turnover

Turnover of total assets employed

* More efficient purchases can lower purchasing cost as part of the cost of sales – gives a higher profit margin
* Asset turnover - more efficient purchases can decrease the extent of the assets employed.
* The smaller the inventory, the fewer the total assets employed and the higher the turnover.

Too few firms regard the purchasing function as an opportunity to increase profits.

***The influence of supply management and general business operations***

The interaction between supply management and other business functions often determines the level of success achieved by these operating units.

The operations/production function depends heavily on the timeous and correct supply of materials to avoid production stoppages and products of poor quality.

The operations function also need to production means such as machinery and equipment and the supporting spares and maintenance. Efficient and effective supply management will ensure a more efficient production process, maximum utilization of production capacity and lower manufacturing costs.

Sales or the marketing function depends on efficient purchasesing.

The human resource function also depends on the efficient purchases ie Equipment or other tangible fringe benefits .

The administrative and finance functions require items such as office furniture, computers and stationary

The activities of the purchasing department affect financial planning to large extent.

Purchasing also plays an important role in public relations.

Changes in the operating environment all contribute to the fact that the impact of supply managements on the internal operations of the firm is in increasing. These include:

* E commerce
* Changes in the market – globalization of markets and changing customer preferences
* The shortened life cycle of products.
* Changes in management philosophy.

**The purchasing cycle: basic steps in supply management.**

The purchasing cycle consists of a series of consecutive steps or small purchasing activities, also known as purchasing procedures.

These include:

* Identification and description of the need
* Source identification and supplier selection
* Bidding and negotiation
* Placing the order/concluding the contract
* Following up and expediting/contract administration.
* Receipt inspection of the incoming goods
* Analyzing the invoice and closing the order

See figure 1.2 of the textbook for a diagram

***Step 1: product identification and specification***

The need for a specific materials, parts and service originates with the users of the goods and services Or in the stores carrying these requirements.

It is important the user functions identify the need in good time to avoid urgent orders.

The description of the requirements of user functions for materials, components and services is communicated to the purchasing function by one of the following documents:

* Purchasing requisitions
* Materials lists – related to a particular production run or product group
* Kanbans – information cards forming part of the JIT system

***Step 2: source identification and selection***

Information technology has contributed much to the efficiency of the purchasing function in this area.

The selection of suppliers requires extraordinary effort and supply management.

For non standard items or large quantities and high expenditure orderss, supply management and should take the responsibility because of its experience and knowledge of the market and trends.

***Step 3: bidding and negotiation***

The process of asking for formal tenders is often not fully described in the purchasing policy and procedures Manual.

Senior management is frequently involved in the final approval of the tender procedure.

The bidding process does not necessarily identify the actual supplier to whom the contract will be awarded – sometimes frowned upon.

***Step 4: placing the order/awarding the contract***

Issuing an official order for the supply of goods and services is a legally binding step. It is essential that the authority and responsibility for placing the orders is vested in only one function – the purchasing function.

It should provide comprehensive information on quantities, prices, delivery dates, point of delivery, quality and discounts.

The order should also indicate whether any specification list or other appropriate documents are attached, forming part of the agreement between buyer and seller.

Once the contract is concluded, it is a crucial task to administer it efficiently to ensure the supplier performs according to the contract.

Purchasing, technical, financial and legal experts can be part of the contract administration team.

Information technology has in many cases done away with the tedious method of committing orders to paper and sending hard copy documents to suppliers.

***Step 5: expediting and contract administration***

This business group within the purchasing function is usually responsible for following up and expediting orders, using a copy of the warder indicating the extent to delivery date.

With EDI buyers can immediately determine the progress of the order so that expediting in the traditional sense is no longer required.

Follow up comes into operation when orders are not received on the delivery date.

The purpose is to ascertain the cause of the delay and to inform suppliers they have failed to deliver. A second and third follow up is often necessary.

Expediting consists of the constant monitoring of the suppliers progress with the order – ensures the supplier does not fall behind schedule

The task of expediting is of particular importance in international purchasing.

***Step 6: receipt inspection***

It is the receiving function to carry out a superficial inspection on delivery – compare quantities and check for damage.

A receiving note, detailing order number, quantities and physical appearance of goods should be completed.

Shortages or deficiencies should be recorded clearly

Copies of the receiving note should be forwarded to the requisitioner

The receiving function is also responsible for the orderly internal distribution of deliveries to user functions

Are faulty consignment may be the result of poor or incorrect communication.

***Step 7: closing the order***

As a first step in closing the order, the suppliers’ invoices analysed by either the purchasing or financial function.

When paying for the order all relevant documents are submitted to the financial function under cover of a request for payment.

The classification of processing transactions into three main categories shows the advent of eprocurement changes the cyclical nature of the steps.

* New task situation – new product or service is purchased for the first time from unknown suppliers
* Straight rebuy – first four states of the cycle are bypassed
* Modified rebuy – purchasing a new product from a known supplier or a known product from a new supplier.

**The purchasing portfolio**

All purchasing transactions are not of equal importance to the buying firm.

Kraljic: 1983 – portfolio of possible purchasing transactions. Based on two main characteristics of supply situations:

* Supply risk – the risk that the firm encounter in the availability of products and services (scarcity)
* Profit impact – contribution to profit of the firm that can be attributed to specific product.

See product classification matrix – figure 1.3 in the textbook

Strategic items have a high impact on profits and the higher supply risk. There are few suppliers for this kind of product or service and the expenditure of the firm on these items is high.

Leverage items also have a higher profit impact but the risk of availability is low. The firm may have high expenditure on these items and there are a large number of suppliers in the market – supply function is in a strong position to use its purchasing power to obtain the best deal.

Not uncritical items are characterized by low supply risk and low profit impact – standard items and firms expenditure is low.

Bottle neck items – hi supply risk and low profit impact. Only few suppliers and supply function has very little leverage due to low expenditure.

**Supply management and related developments - SCM**

The term supply chain management is not yet universally accepted as descriptive of the exciting new approach aimed at enhancing Customer service and providing a firm with the competitive advantage Through the efficient management of the flow of materials and services.

SCM is a management philosophy aimed at integrating a network of upstream linkages, internal linkages inside the organization and downstream linkages in performing specific processes and activities.These will ultimately create value for the customer in the form of products and services.

C figure 1.4 in the textbook – the supply chain model

The above depicts the integration of all activities involved in the flow of materials and services, and shows that the supply chain as a whole is focused on creating value for the customer.

It should be noted that the figure emphasizes process management as opposed to functional management. The fully integrated supply chain, processes are managed across the functional and organizational boundaries.

Important to understand that the supply chain philosophy focuses on the processes that are required to create value in the supply chain and not on the typical business functions.

Some of the most important processes of a supply chain are:

* Customer driven supply chain – customer defined product or service and this information is fed through the information system back to the supply chain. Focus of the supply chain processes is the end of the supply chain
* Efficient logistics – ensure the least cost in the supply chain welcome performing to or exceeding customer requirements.
* Demand driven sales planning – linked to the customer driven demand, the volume and mix of demand are the trigger mechanisms for all other processes. The sales planning of the ultimate supplier to the end customer would before by demand driven.
* Lean manufacturing – most effective operation of all manufacturing processes – should be fully integrated with the rest of the supply chain
* Information processing
* Sourcing – a key process. Represents the upstream extension of the supply chain and may include second and third tier suppliers of the primary firm.

**Key concepts in SCM**

***Value and creation of customer value***

Contribution of the supply chain in creating value can be found in:

* Quality of the inputs,
* the optimization of input costs
* timeliness of transformations
* customer satisfaction

***Total cost of ownership***

In supply chain provides a competitive advantage by ensuring that the total cost over the whole supply chain is optimized and the advantage is passed on to the end customer.

***Integration of processes***

The endeavor to optimize value, delivery processes are managed as processes across functional boundaries.

***Reduction of cycle time***

Being more responsive to ever changing customer demands, being able to anticipate customer requirements, being able to reduce lead times for efficient logistic processes

**Characteristics of supply chain management**

* SCM is a management philosophy – sharing risks, benefits and rewards for long term cooperation
* Supply chains consist of multiple layers of companies striving to optimize the supply chain process
* Organisations may be involved in multiple supply chains of many other organisations
* All links and interfaces in the supply chain are not of equal importance
* Information sharing in SCM occurs across the breadth of the supply chain.
* Comparable corporate philosophies are essential in achieving the necessary levels of planning and coordination
* SCM is based on a shared vision of what customer value is

***Logistics management***

Part and parcel of SCM**.** Refers to the inbound and outbound flow in storage of goods , services and informationwithin and between organisations.

See figure 1.5 in the textbook.

That in order for quench it