

Procurement & Supply Chain
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Chapter 3

The purchasing management process

Learning objectives

- The major tasks and responsibilities of purchasing.
- The basic principles on which purchasing policy can be based.
- The major policy areas in purchasing.
- How purchasing may develop over time as a business function.

Primary tasks and responsibilities

- Operational excellence.
- Cost control and reduction of all purchasing-related spend.
- Risk management.
- Innovation/Continuous improvement.

Changing purchase agenda

FIGURE 3.1 Managing the purchasing agenda: balancing cost-risk-value

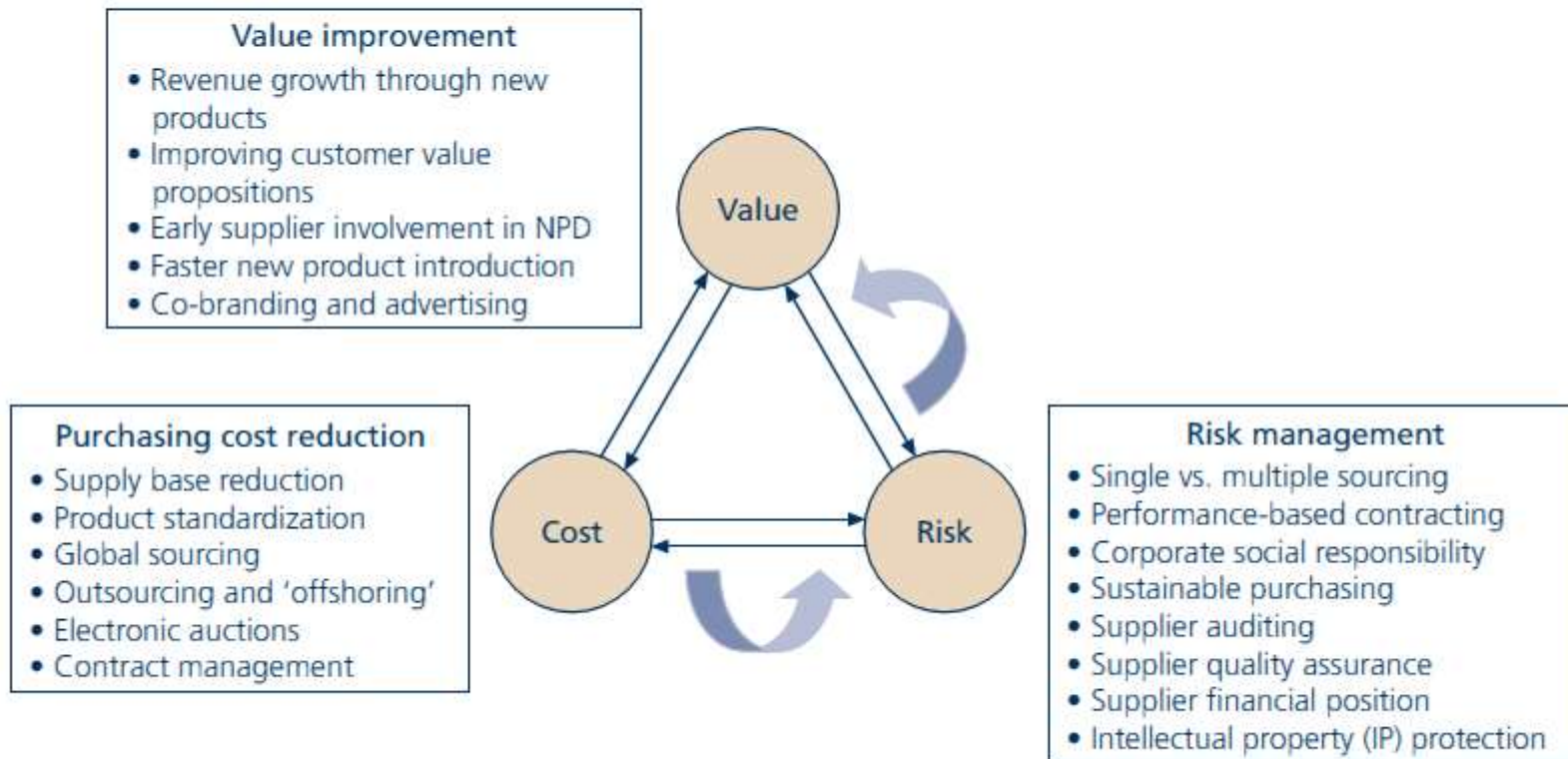
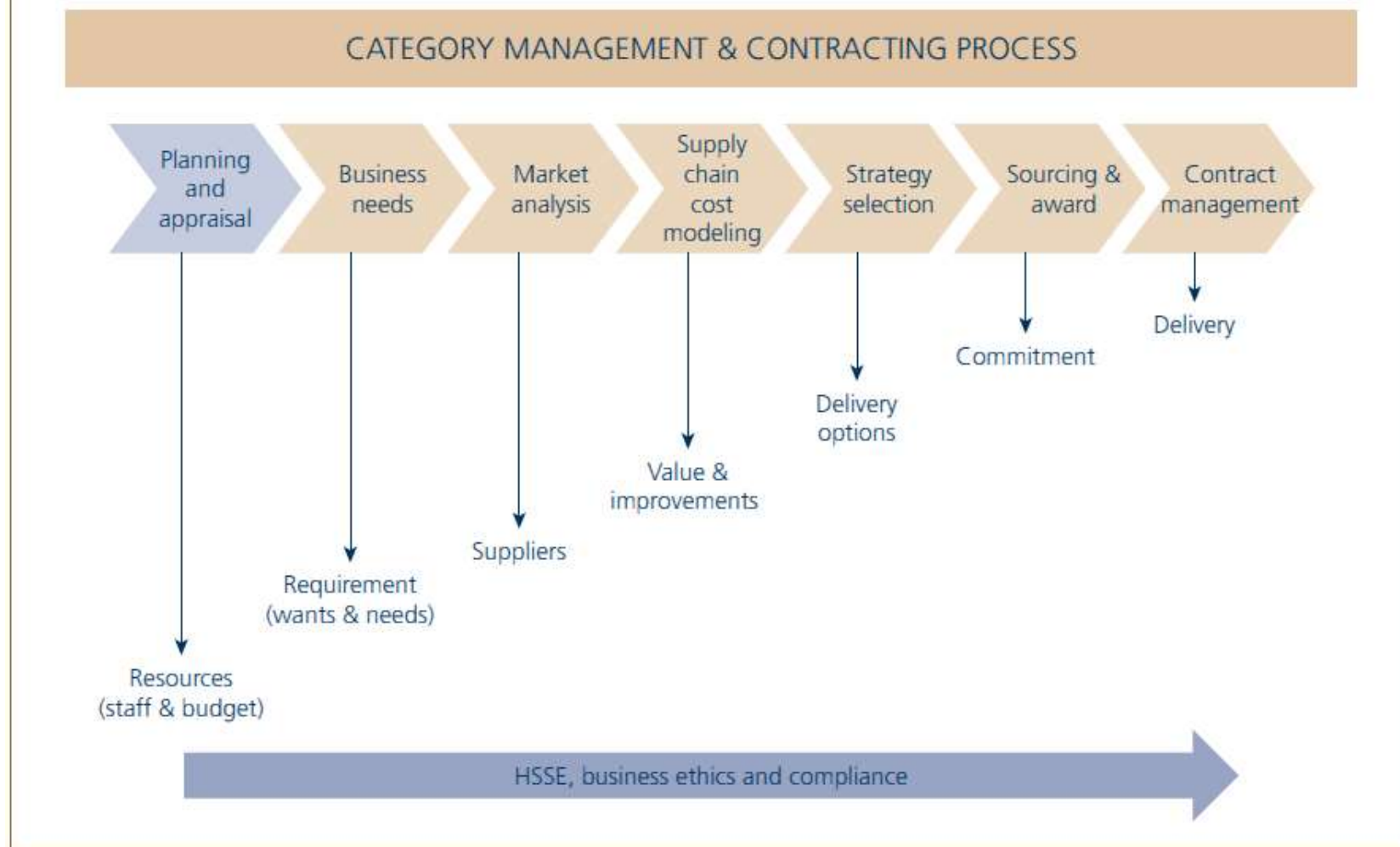


FIGURE 3.2 Purchasing process model Shell Global Solutions International



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Standard purchasing procedure (I)

1. **Send an offer of collaboration** to the best companies, the offer contains the specifications and final reply date (confidential)
2. Reject offers delivered after the deadline
3. Proceed with an **opening session of the letters**
4. **Countersign the offers**
5. Draw up a comparative table of costs
6. Proceed with a consistency check on technical level
7. **Preselect the two best proposals** (quality and costs)

Standard purchasing procedure (II)

8. Check the references
9. Draw up assessment grid of recent realizations
10. Compare costs and **renegotiate** item by item
11. Recommend a final choice
12. Maintain contact with the other supplier (avoid monopoly)
13. Draft the **contract** with legal department
14. Write to the companies not chosen to notify them of refusal
15. Regularly sound out the competition
16. Preserve our partners' long-term motivations

Professionalizing purchasing

Major principles of purchasing policies:

- Business alignment
 - Develop a purchasing and supply strategy
- Integrated, cross-functional approach
 - Purchasing decisions cannot be made in isolation, and should not be aimed at optimization of purchasing performance only
- Performance driven
 - Purchasing engages in a healthy debate with its internal customers

Purchasing management process

- **Purchasing and supply (market) research**

Purchasing and supply (market) research refers to the systematic study of all relevant factors which may affect supply and demand of goods and services, for the purpose of securing the company's current and future requirements.

- **Purchasing and supply objectives, strategy and planning**

Based upon the company's overall objectives, purchasing objectives will relate to cost-reduction, improving product quality, lead time reduction etc. Through these objectives the company directs, manages and controls its purchasing activities and supplier strategies. Management can focus on different areas for action:

Purchasing management process

- **Implementation of purchasing policy**

Areas to consider:

- Supply
- Product and supplier quality
- Materials cost policy
- Supplier policy
- Communication policy

- **Control and Evaluation**

Results and activities which have been planned must be realized within the available financial resources. Actual performance must be periodically checked against purchasing plans .

FIGURE 3.4 The purchasing management process

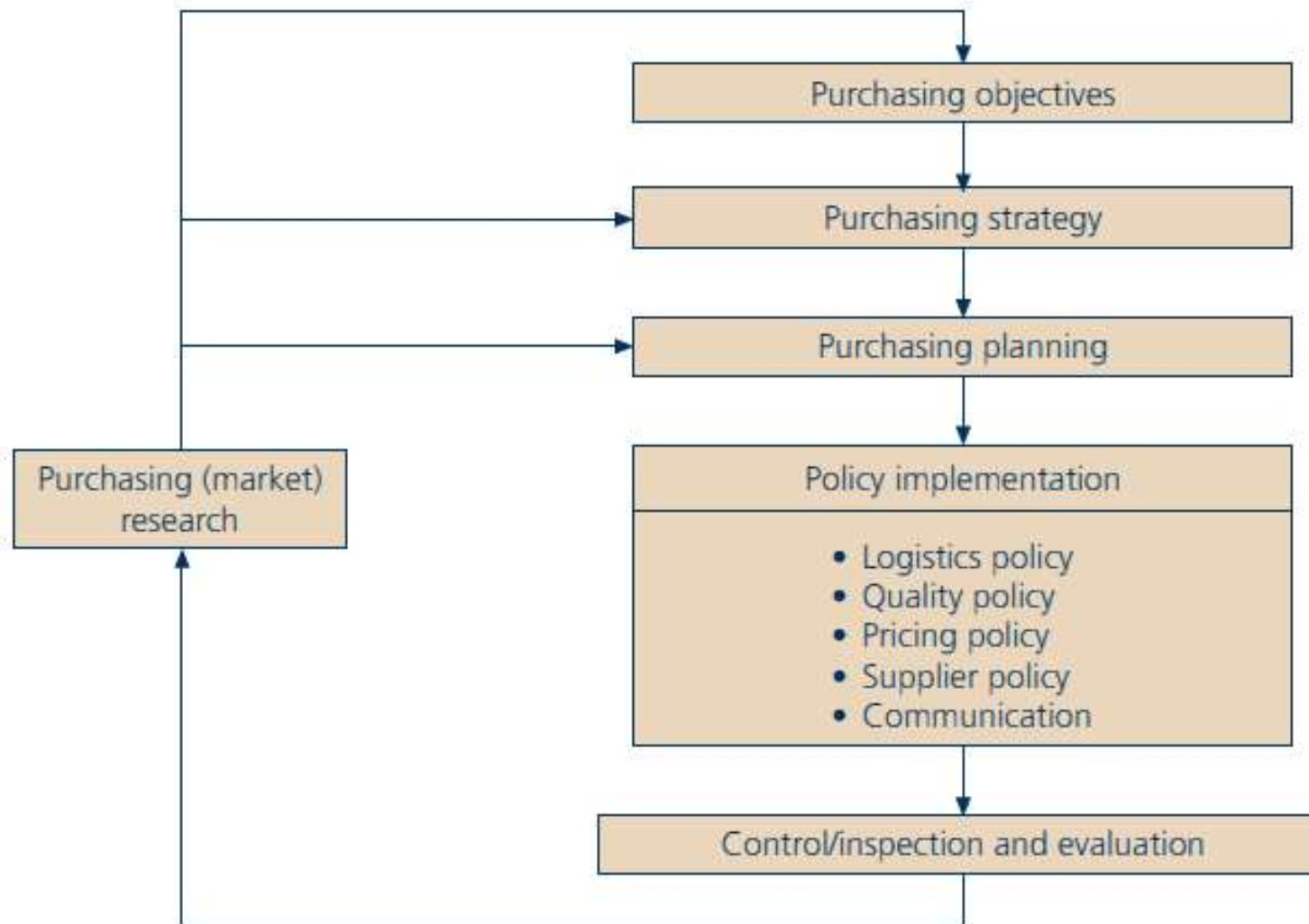


FIGURE 3.5 Examples of areas for action in purchasing

Sourcing policy – determining dependency on suppliers and designing plans to reduce this dependency.

Direct vs. indirect buying – determining the (possible) cost benefits of buying from importers and distributors, or buying directly from the manufacturer.

Make-or-buy analysis – analysis of savings opportunities by eliminating particular production activities and buying the required products from third parties; buy-or-lease may be considered as an alternative.

Integration between purchasing and other functional areas – plans aimed at removing interface problems between purchasing and materials management, purchasing and engineering and between purchasing and financial administration or treasury.

Setting up a purchasing information and control system – analysis of purchasing's information needs and design of an automation plan; possibilities of linking this system with existing information systems in other functional areas.

Centralized or decentralized purchasing – balancing cost benefits and strategic considerations related to a centralized or decentralized organization of purchasing.

Standardization – determining possibilities to achieve standardization in order to reduce product and supplier variety; balancing savings and risks.

TABLE 3.1 Aspects of purchasing policy

<i>Tools</i>	<i>Aspects</i>
Supply policy	Purchasing order processing Materials and supply planning Warehousing and inventory management
Product and supplier quality policy	Early involvement in new product development Improving suppliers' quality performance
Materials cost policy	Control of materials costs and prices Reduction of materials costs and prices Reduction of logistics and transportation cost Reduction of transaction cost
Supplier policy	Sourcing policy Improvement of supplier performance Intellectual property
Communication policy	Internal communication External communication Business values, integrity and ethics

Development of purchasing over time

Step-wise development of purchasing on the following characteristics:

- Integrated final stage
 - Management is actively involved in purchasing strategies and tactics, organized around team-based structures
- Organizational status of purchasing
 - Centralization often leads to some form of coordinated purchasing
- Supplier management
 - From reactive purchasing, via proactive purchasing, to relationship management
- Supplier relationships
 - Reduced number of (preferred) suppliers and closer relationships

Drivers of development

- Business context
 - More competition, more mature technology used → more pressure towards purchasing
- Company strategy
 - More explicit about goals and objectives, more formalized planning process → greater chance purchasing is integrated in company strategy
- System development
 - Information and communication technologies are important enablers for modern purchasing concepts
- Top management commitment
- Functional leadership

FIGURE 3.6 Purchasing and supply development model (example)

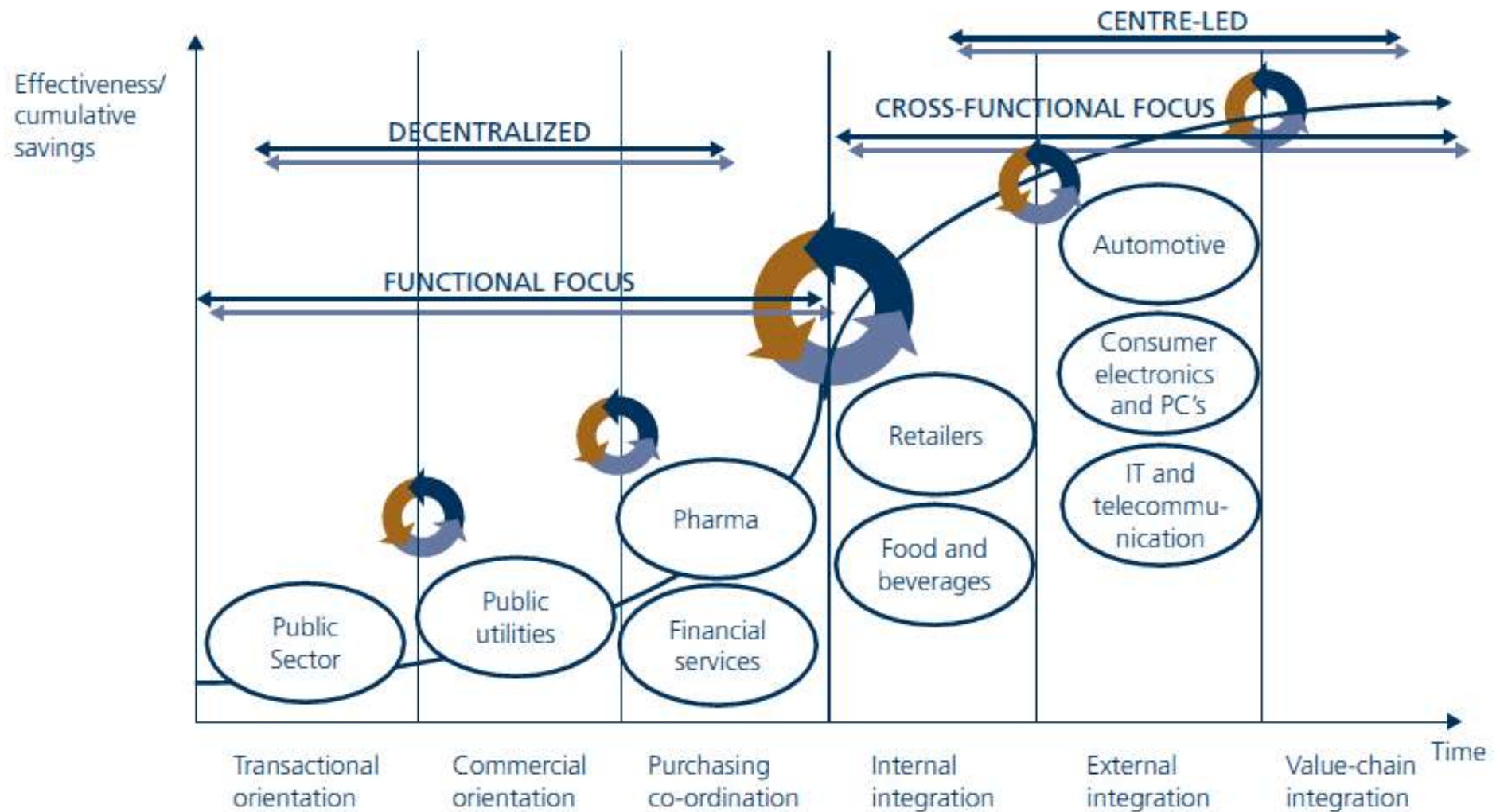


FIGURE 3.6 Purchasing and supply development model

Focus	'Serve the factory'	'Reduce cost'	'Savings through synergy'	'Total cost of ownership'	'Supply chain optimization'	'Total customer satisfaction'
Activities	<ul style="list-style-type: none"> • Clerical • Order processing 	<ul style="list-style-type: none"> • Commercial • Tendering • Negotiating • Approved supplier lists 	<ul style="list-style-type: none"> • Commercial • Contracting • Global sourcing 	<ul style="list-style-type: none"> • Cross-functional buying teams • Systems integration • Vendor rating, etc. 	<ul style="list-style-type: none"> • Outsourcing • EDI/Internet • E-commerce • Cost models 	<ul style="list-style-type: none"> • Customer-driven activities • Contact manufacturing • Supplier development • Global supplier network
Dilemmas	<ul style="list-style-type: none"> • Initial purchasing • Control of purchasing • Expenditure 	<ul style="list-style-type: none"> • Supplier base management 	<ul style="list-style-type: none"> • Contract management • Ethics 	<ul style="list-style-type: none"> • Communication and information infrastructure 	<ul style="list-style-type: none"> • Social resistance 	<ul style="list-style-type: none"> • Internationalization • HRM

Purchasing and supply development model

Stage 1: Transaction orientation

- The primary task of purchasing is to find appropriate suppliers for raw materials and supplied components. There is no explicit purchasing strategy in place.

Stage 2: Commercial orientation

- Purchasing strategy at this stage is characterized by a sharp focus on low prices. The culture is that of playing hard negotiations with many suppliers.

Stage 3: Co-ordinated purchasing

- Led by a strong central purchasing department to implement uniform buying policies and systems, the emphasis here lies on cross unit co-ordination and compliance with nationally negotiated contracts.

Purchasing and supply development model

Stage 4: Internal integration

- The emphasis is on cross-functional problem solving with the objective of reducing total life cycle cost and not just the unit cost of components.

Stage 5: External integration

- An explicit outsourcing strategy is combined with extra attention to collaborate with supply chain partners on product development and preproduction planning.

Stage 6: Value chain orientation

- Delivering value to the end customer in order to satisfy the needs in end-customer markets. Subcontractors seek for support among their suppliers.

This model should be applied carefully; all stages may not be relevant for all types of commodities, companies and industries.

Summary

- Purchasing objectives should be aligned with corporate strategies.
- The **systematic** approach of the purchasing management process can help make this potential visible and accessible.
- It takes time to put all the elements of the purchasing management process in place.
- Purchasing automation has improved and freed up the buyers from administrative and operational duties.
- Purchasing has become more **integrated** with other business domains, such as operations management and supply chain management.