

PURCHASING PROCESS

Importance of Purchasing Process

- **Purchasing is an important function of materials management.** In any **industry purchase** means **buying of equipment, materials, tools, parts** etc. required for **industry**.
- The **importance of the purchase function varies with nature and size of industry.**
- In **small industry**, this function is performed by **works manager** and in **large manufacturing concern**; this function is done by a **separate department**.
- The moment a buyer **places an order**, he commits a substantial portion of the **finance** of the corporation which affects the **working capital** and **cash flow** position.
- He is a **highly responsible person** who meets various **salesmen** and thus can be considered to have been **contributing to the public relations efforts** of the company.
- Thus, the buyer can make or mar the **company's image** by his excellent or poor relations with the vendors.

Objectives of Purchasing

- The **basic objective of the purchasing function is to ensure continuity of supply of raw materials, sub-contracted items and spare parts and to reduce the ultimate cost of the finished goods.**
- In other words, **the objective is not only to procure the raw materials at the lowest price but to reduce the cost of the final product.**

Objectives of Purchasing

- The objectives of the purchasing department can be outlined as under:
 1. **To avail the materials, suppliers and equipments at the minimum possible costs:**
These are the inputs in the manufacturing operations. The minimization of the input cost increases the productivity and resultantly the profitability of the operations.
 2. **To ensure the continuous flow of production** through continuous supply of raw materials, components, tools etc. with repair and maintenance service.
 3. **To increase the asset turnover:** The investment in the inventories should be kept minimum in relation to the volume of sales. This will increase the turnover of the assets and thus the profitability of the company.
 4. **To develop an alternative source of supply:** Exploration of alternative sources of supply of materials increases the bargaining ability of the buyer, minimization of cost of materials and increases the ability to meet the emergencies.

Objectives of Purchasing (2)

5. **To establish and maintain the good relations with the suppliers:** Maintenance of good relations with the supplier helps in evolving a favourable image in the business circles. Such relations are beneficial to the buyer in terms of changing the reasonable price, preferential allocation of material in case of material shortages, etc.
6. **To achieve maximum integration with other department of the company:** The purchase function is related with **production department** for specifications and flow of material, **engineering department** for the purchase of tools, equipments and machines, **marketing department** for the forecasts of sales and its impact on procurement of materials, **financial department** for the purpose of maintaining levels of materials and estimating the working capital required, **personnel department** for the purpose of manning and developing the personnel of purchase department and maintaining good vendor relationship.

Objectives of Purchasing (3)

7. **To train and develop the personnel:** Purchasing department is manned with varied types of personnel. The company should try to build the imaginative employee force through training and development.
8. **Efficient record keeping and management reporting:** Paper processing is inherent in the purchase function. Such paper processing should be standardised so that record keeping can be facilitated. Periodic reporting to the management about the purchase activities justifies the independent existence of the department.

Parameters of Purchasing

- The success of any manufacturing activity is largely dependent on the procurement of raw materials of right quality, in the right quantities, from right source, at the right time and at right price popularly known as ten 'R's' of the art of efficient purchasing.
- They are described as the basic principles of purchasing.
- There are other well known parameters such as right contractual terms, right material, right place, right mode of transportation and right attitude are also considered for purchasing.

Parameters of Purchasing



1. RIGHT PRICE

- It is **the primary concern** of any manufacturing organization to get an item at **the right price**. But **right price need not be the lowest price**. It is very difficult to determine the right price; general guidance can be had from the cost structure of the product.
- The **'tender system'** of buying is normally used in **public sector organizations** but the objective should be to identify **the lowest 'responsible' bidder** and not **the lowest bidder**.
- The technique of **'learning curve'** also helps the **purchase agent** to determine **the price of items with high labour content**.
- **The price** can be **kept low** by **proper planning** and not by **rush buying**. **Price negotiation** also helps to **determine the right prices**.

2. RIGHT QUALITY

- **Right quality** implies that quality should be **available, measurable** and **understandable** as far as **practicable**.
- In order to determine the quality of a product, **sampling schemes** will be useful.
- The **right quality** is determined by **the cost of materials** and **the technical characteristics** as suited to **the specific requirements**.
- The **quality particulars** are **normally obtained** from **the indents**.
- Since **the objective of purchasing** is to **ensure continuity of supply** to the user departments, **the time** at which the material is provided to **the user department** assumes **great importance**.

3. RIGHT TIME

- For **determining the right time**, the **purchase manager** should have **lead time** information for **all products** and **analyze its components** for **reducing the same**.
- **Lead time** is **the total time elapsed** between **the recognition of the need of an item** till **the item arrives** and is **provided for use**. This covers **the entire duration of the materials cycle** and **consists of pre-contractual administrative lead time, manufacturing and transporting lead time and inspection lead time**.
- Since **the inventory increases with higher lead time**, it is desirable to analyze each component of the lead time so as to **reduce the first and third components** which are **controllable**. While **determining the purchases**, the buyer has to **consider emergency situations like floods, strikes, etc.**

4. RIGHT SOURCE

- **The source** from which the material is procured should be **dependable** and **capable of supplying items of uniform quality**.
- The buyer has to decide which item should be directly obtained from the manufacturer.
- Source selection, source development and vendor rating play an important role in buyer-seller relationships.
- In emergencies, open market purchases and bazaar purchases are restored.

5. RIGHT QUANTITY

- The right quantity is **the most important parameter** in buying.
- **Concepts**, such as, economic order quantity, economic purchase quantity, fixed period and fixed quantity systems, will serve as **broad guidelines**.
- But the buyer has to use his **knowledge, experience** and **common sense** to **determine the quantity** after considering factors such as **price structure, discounts, availability of the item, favourable reciprocal relations**, and **make or buy** consideration.

6. RIGHT ATTITUDE

- Developing the right attitude, too, is necessary as one often comes across such statement:
 - 'Purchasing knows the **price of everything** and **value of nothing**';
 - 'We **buy price** and **not cost**';
 - 'When will our **order placers** become **purchase managers**?';
 - 'Purchasing acts like a post box'.
- Therefore, **purchasing** should keep 'progress' as its key activity and should be **future-oriented**.
- The purchase manager **should be innovative** and his **long-term objective** should be to **minimise the cost** of the ultimate product.
- He will be able to achieve this if he aims himself with techniques, such as, **value analysis, materials intelligence, purchases research, SWOT analysis, purchase budget, lead time analysis**, etc.

7. RIGHT CONTRACTS

- The buyer has to adopt **separate policies** and procedures for capital and consumer items.
- He should be **able to distinguish between indigenous and international purchasing** procedures.
- He should be aware of **the legal and contractual aspects** in **international practices**.

8. RIGHT MATERIAL

- **Right type of material** required for **the production** is an **important parameter** in purchasing.
- **Techniques**, such as, **value analysis** will enable the buyer **to locate the right material**.

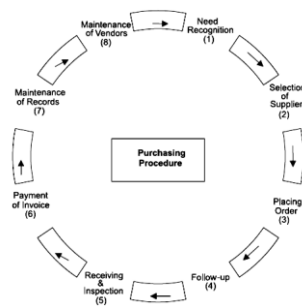
9. RIGHT TRANSPORTATION

- **Right mode of transportation** have to be identified as this forms a **critical segment in the cost profile** of an item.
- It is an established fact that **the cost of the shipping of ore, gravel, sand, etc., is normally more than the cost of the item itself.**

10. RIGHT PLACE OF DELIVERY

- Specifying **the right place of delivery**, like **head office or works**, would **often minimize the handling and transportation cost.**

Purchasing Procedure



Purchasing Procedure: 1. Recognition of The Need

- The **initiation of procedure** starts with the **recognition of the need** by the needy section. The demand is lodged with the purchase department in the **prescribed Purchase Requisition Form** forwarded by the **authorized person** either **directly or through the Stores Department.**
- The **purchase requisition** clearly specifies the details, such as, **specification of materials, quality and quantity, suggested supplier, etc.**
- Generally, **the low value sundries and items of common use are purchased for stock** while **costlier and special items** are purchased according to the **production programmes.**
- Generally, the **corporate level executives** are **authorized signatories** to such demands.
- Such purchases are **approved by the Board of Directors.** The **reference of the approval is made on requisition** and a **copy of the requisition** is sent to the **secretary** for the purpose of **overall planning and budgeting.**

Purchasing Procedure: 2.The Selection of The Supplier

- The process of selection of supplier involves two basic aspects: searching for all possible sources and short listing out of the identified sources. The complete information about the supplier is available from various sources such as trade directories, advertisement in trade journals, direct mailing by the suppliers, interview with suppliers, salesmen, suggestions from business associates, visit to trade fair, participation in industries convention, etc.
- Identification of more and more sources helps in selecting better and economical supplier. It should be noted that the low bidder is not always the best bidder. When everything except price is equal, the low bidder will be selected.
- The important considerations in the selection are the price, ability to supply the required quantity, maintenance of quality standards, financial standing etc. It should be noted that it is not necessary to go for this process for all types of purchases. *For the repetitive orders and for the purchases of low-value, small lot items, generally the previous suppliers with good records are preferred.*

Purchasing Procedure: 3. Placing The Order

- Once the supplier is selected the next step is to place the purchase order.
- Purchase order is a letter sent to the supplier asking to supply the said material.
- At least six copies of purchase order are prepared by the purchase section and each copy is separately signed by the purchase officer.
- Out these copies, one copy each is sent to store-keeper, supplier, accounts section, inspection department and to the department placing the requisition and one copy is retained by the purchase department for record.

Purchasing procedure: 4. Follow-up Of The Order

- Follow-up procedure should be employed wherever the costs and risks resulting from the delayed deliveries of materials are greater than the cost of follow-up procedure, the follow-up procedure tries to see that the purchase order is confirmed by the supplier and the delivery is promised.
- It is also necessary to review the outstanding orders at regular intervals and to communicate with the supplier in case of need.
- Generally, a routine urge is made to the supplier by sending a printed post card or a circular letter asking him to confirm that the delivery is on the way or will be made as per agreement.
- In absence of any reply or unsatisfactory reply, the supplier may be contact through personal letter, phone, telegram and/or even personal visit.

Purchasing procedure: 5. Receiving and Inspection of The Materials

- The receiving department receives the materials supplied by the vendor.
- The quantity are verified and tallied with the purchase order. The receipt of the materials is recorded on the specially designed receiving slips or forms which also specify the name of the vendor and the purchase order number.
- It also records any discrepancy, damaged condition of the consignment or inferiority of the materials. The purchase department is informed immediately about the receipt of the materials. Usually a copy of the receiving slip is sent to the purchase department.

Purchasing procedure:
6. Payment of The Invoice

- When **the goods are received** in satisfactory condition, **the invoice** is checked **before it is approved** for the payment.
- **The invoice** is checked to see that **the goods** were **duly authorized to purchase**, they were **properly ordered**, they are **priced as per the agreed terms**, **the quantity and quality confirm to the order**, the calculations are arithmetically correct etc.

Purchasing procedure:
7. Maintenance of The Records

- **Maintenance of the records** is an **important part** and **parcel of the efficient purchase** function.
- In the **industrial firms**, most of **the purchases** are **repeat orders** and hence **the past records** serve as a **good guide for the future action**.
- They are very useful for **deciding the timings** of **the purchases** and in **selecting the best source** of the supply.

Purchasing procedure:
8. Maintenance of Vendor Relations

- The **quantum** and **frequency** of the **transactions** with the **same key suppliers** provide a **platform for the purchase department** to **establish and maintain good relations** with them.
- **Good relations** develop **mutual trust** and **confidence** in the **course of the time** which is **beneficial to both the parties**.
- The **efficiency of the purchase department** can be **measured by the amount of the goodwill** it has with its suppliers.

Selection of Suppliers

- **Selection of the right supplier** is the **responsibility of the purchase department**.
- It can **contribute substantially** to the **fundamental objectives** of the **business enterprise**.
- **Different strategies** are required for **acquiring different types of materials**.
- The **selection of supplier** for **standardized products** will differ from **non-standardised products**.

Factors affecting the selection of suppliers

1) SOURCES OF SUPPLIER

2) DEVELOPMENT OF APPROVED LIST OF SUPPLIERS

3) EVALUATION AND SELECTION OF THE SUPPLIER

- a) Cost Factors
- b) Delivery
- c) Design and Specification Factors
- d) Legal Factors
- e) Vendor Rating

SOURCES OF SUPPLIER

- The best buying is possible **only when** the decision maker is familiar with **all possible sources of supply** and their respective terms and conditions.
- The **purchase department** should **try to locate the appropriate sources of the supplier** of various types of materials. This is known as 'survey stage'.
- A survey of the following will help in developing the possible sources of supply:
 1. Specialised trade directories.
 2. Assistance of professional bodies or consultants.
 3. The buyer's guide or purchase handbook.
 4. The manufacturer's or distributor's catalogue.
 5. Advertisements in dailies.
 6. Advertisement in specialised trade journals.
 7. Trade fair exhibitions.

DEVELOPMENT OF APPROVED LIST OF SUPPLIERS

- The survey stage highlights the existence of the source. A business inquiry is made with the appropriate supplier. It is known as 'Inquiry Stage'. Here a short listing is made out of the given sources of suppliers in terms of:

- production facilities and capacity,
- financial standing,
- product quality,
- possibility of timely supply,
- technical competence,
- manufacturing efficiency,
- general business policies followed,
- standing in the industry,
- competitive attitude, and
- interest in buying orders etc.

EVALUATION AND SELECTION OF THE SUPPLIER

The **purchase policy** and **procedure** differ according to the **type of items** to be purchased. Hence, **evolution and selection of the supplier** differ accordingly. The following variables to be considered while **evaluating the quotations of the suppliers**:

1. Cost Factors

Price, transportation cost, installation cost if any, **tooling** and other **operations cost**, incidence of **sales tax** and **excise duty**, **terms of payment** and **cash discount** are considered in **cost factor**.

2. Delivery

Routing is important in determining the point at which the title to the goods passes from **vendor to the buyer** and the responsibility for the payment of the payment charges.

EVALUATION AND SELECTION OF THE SUPPLIER (2)

3. Design and Specification Factors

Specification compliance, specification deviations, specification advantages, important dimensions and weights are considered in line with the demonstration of sample, experience of other users, after sale services etc.

4. Legal Factors

Legal factors include warranty, cancellation provision, patent protection, public liability, federal laws and reputation compliance.

Vendor Rating

- The evaluation of supplier or vendor rating provides valuable information which help in improving the quality of the decision.
- In the vendor rating three basic aspects are considered namely quality, service and price.
- How much weight should be given to each of these factors is a matter of judgment and is decided according to the specific need of the organization.
- Quality would be the main consideration in the manufacturing of the electrical equipments while price would be the prime consideration in the product having a tense competitive market and for a company procuring its requirements under the blanket contract with agreed price, the supplier rating would be done on the basis of two variables namely quality and delivery.