PROCUREMENT PRINCIPLES AND PRACTICE



PCM 102

LECTURE 5:

Identifying needs and Developing Specification





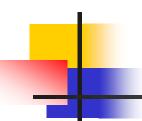
- Identifying Procurement Needs
- Definitions of specifications
- The importance of specifications in contracts with external customers and suppliers
- Creating specifications for products and services
- Service level agreements
- Conformance and output or outcome-based approaches to developing specifications
- The role of key performance indicators (KPIs)



- A needs identification process defines the reasons why you plan to buy goods, works or services.
- When starting your procurement planning, it is important to define the reasons why you need to buy goods.

How needs arises

- Procurement needs for goods, works or services may arise from various sources, including:
- government decisions, such as to acquire a new or revised capability
- a decision made by your organisation's management
- market or social demand
- technology impacting how your organisation operates
- advice from management or a consultant to upgrade an IT system, replace equipment or refurbish a building



Needs definition

- In reviewing needs from customers, the four major items that have to be brought into harmony are:
- 1. Design considerations of function
- 2. Marketing considerations of consumer acceptance and satisfaction
- 3. Manufacturing considerations of economic production
- 4. Procurement considerations of markets, materials availability, supplier capability and cost.



- Developing specification is an important step in the procurement process.
- Its role is to establish a detailed description of the requirement which can be communicated to potential suppliers.
- Detailed descriptions may already exist if the purchase is a re – buy for example.



- However, for new procurement, they may have to be drawn up, in the form:
 - Specifications
 - Service level agreements
 - Contract terms which contains the obligations of buyer and seller in relation to the fulfilment of the specification



- A specification can simply be defined as a statement of the requirements to be satisfied in the supply of a product or service.
- Specification: a detailed description of the design and materials used to make something.
- A statement prescribing materials, dimensions and quality of work for something to be purchased, built, installed or manufactured.

Importance of Specification

- Define the requirement
- Communicate the requirement clearly to suppliers, so that they can plan to conform and perhaps also use their expertise to come up with innovative or lower –cost solutions to the requirement
- minimize risk and cost associated with doubt, ambiguity, misunderstanding or dispute as to requirement and what constitutes satisfactory quality and fitness for purpose
- Support standardization and consistency, where items are procured from more than one source.



- Detailed specification is an expensive and time consuming process, and almost certainly uneconomical for small value purchases
- The costs of inspection and quality control are greater than if a simpler form of need definition(example, if the brand name) is used
- Specification can create a temptation to over specify, increasing cost (without necessarily adding value)



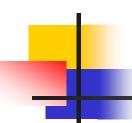
Types of specification

The two main types of specification are

- Conformance and
- Performance specification

Conformance Specification

- Conformance specification occurs when the buyer details exactly what the required product, part or material must consist of.
- The supplier may not know in detail or even at all, what function the product will play in buyer's manufacturing.



Examples of conformance specification

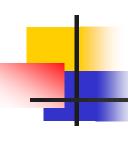
- An engineering drawing, design or blueprint such as construction
- A chemical formula or recipe or prescription sent to a pharmacy shop
- Specific identification of a brand name or model number
- Providing a sample of the product

Cont'd

- Performance specification: unlike conformance, the buyer describes what the product, part or material to be supplied should achieve or be used for.
- This type of specification shifts the risks of non performance to the supplier.
- It also helps to benefit from current knowledge and skills of the supplier with respect to the supply of a good or service



Performance specification is a relatively brief document(compared to conformance specification), in which the buyer describes what it expects a part or material to be able to achieve, in terms of the functions it will perform ,the level of performance it should reach, and any relevant input parameters and operating conditions.



Advantages of performance specification over conformance specification

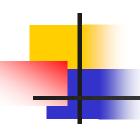
- Performance specification is easier and cheaper to draft
- Supplier can use their full expertise, technologies and knowledge to meet requirements to the optimum
- The potential supplier base is wider than with the conformance specification



- Service level agreements (SLAs) are formal statements of performance requirements, specifying the exact nature and level of service to be provided by a service supplier, as part of a service specification.
- For example an agreement between an ISP and a customer may include an internet speed: download 300Mb/s and upload 100Mb/s
- It provides a performance indicator against which the suppliers performance will be measured.



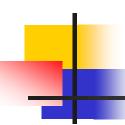
- The purpose of service level agreement is to define the customer's service level needs and secure the commitment of the supplier to meeting those needs
- This can then be used as a yardstick against which to measure the supplier's subsequent performance, conformance (meeting standards) and compliance (fulfilling agreed terms).



Benefits of Effective Service Level Agreements

- 1. The clear identification of customers and providers, in relation to specific services.
- 2. The focusing of attention on what services actually involve and achieve.
- 4. Better customer awareness of what services they receive, what they are entitled to expect, and what additional services or levels of service a provider can offer.

- 5. Better customer awareness of what a service or level of service costs, for realistic cost-benefit evaluation
- 6. Support for the ongoing monitoring and periodic review of services and service levels.
- 7. Support for problem solving and improvement planning, by facilitation customers in reporting failure to meet service levels.

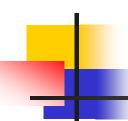


Contents of a Service Level Agreement

- The basic elements of a service level agreements are as follows:
- 1. What services are included (and not included, or included only on request and at additional cost)
- 2. Standards or levels of service (such as response toes, speed and attributes of quality service)
- 3. The allocation of responsibility for activities, risks and costs



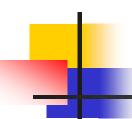
- 4. How services and service levels will be monitored and reviewed, what measures of evaluation will be used, and how problems (if any) will be addressed.
- 5. How complaints and disputes will be managed
- 6. When and how the agreements will be reviewed and revised.



Key Performance Indicator

A Key Performance Indicator is a measurable attribute, value or outcome that demonstrates how effectively a company is achieving key business objectives.

These KPIs enable the procurement department to control and optimize the quantity, quality, costs, timing and sourcing of purchasing processes



Benefits of KPIs cont'd

- The ability directly to compare year on year performance, to identify improvement or deterioration trends so that actions can be taken in the future to prevent further occurrences
- Focus on key results areas (critical success factors) such as cost reduction and quality improvement
- Reduced conflict arising from causes such as goal confusion and unclear expectations.



- Setting KPIs for supplier performance in particular, may be beneficial in the following areas.
 - Setting clear performance criteria and expectations: motivating compliance and improvement
 - Managing supply risk: controlling quality, delivery, value for money and so on
 - Supporting contract management (to ensure that agreed benefits are obtained)
 - Providing feedback for learning and continuous improvement in the buyer-supplier relationship- both for the supplier, and for the purchasing department.

Types of KPIs

- KPIs may be developed around all the five rights.
- However the most frequently occurring KPI are Cost Savings, Quality, and Delivery of purchased items



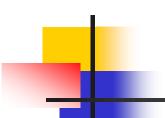


- **Cost savings KPI**: Measuring the percentage of managed spend against total spend on purchases for external products and services.
- Goal of this KPI is to have more spend standard procedures, thereby saving on costs.
- An organization can exclude things that they can they can do without or substitute, for example the reduction of travel expenses by deployment of video conferencing



• Quality KPI:

- Obtaining goods which are of a satisfactory quality as well as fit-for-purpose
- Products and services of low quality would affect an organizations product quality which might add additional costs.
- Metrics such as percentage of rejections, goal is to lower these percentages, rejected services from service providers, lowering the disapproval rate.



Delivery KPI:

- To establish strategies that can improve delivery as well as continuity of supply.
- Strategic supply is important for organizations, late deliveries might affect supply chain continuity, early deliveries can result in higher operational/Inventory costs.
- The goal is to have lower number of errors against the requested time frame for deliveries