PURCHASING PROCESS

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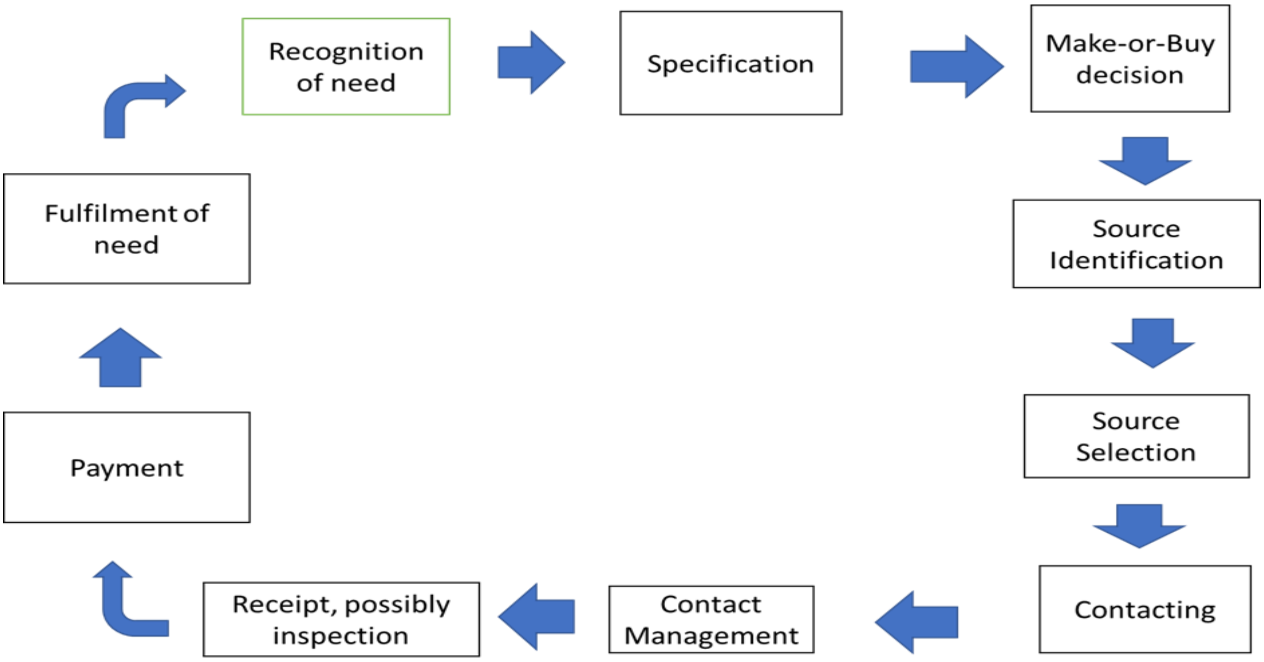
INTRODUCTION

This paper will focus on identifying a commercial process which will be the purchasing cycle as shown in figure one below

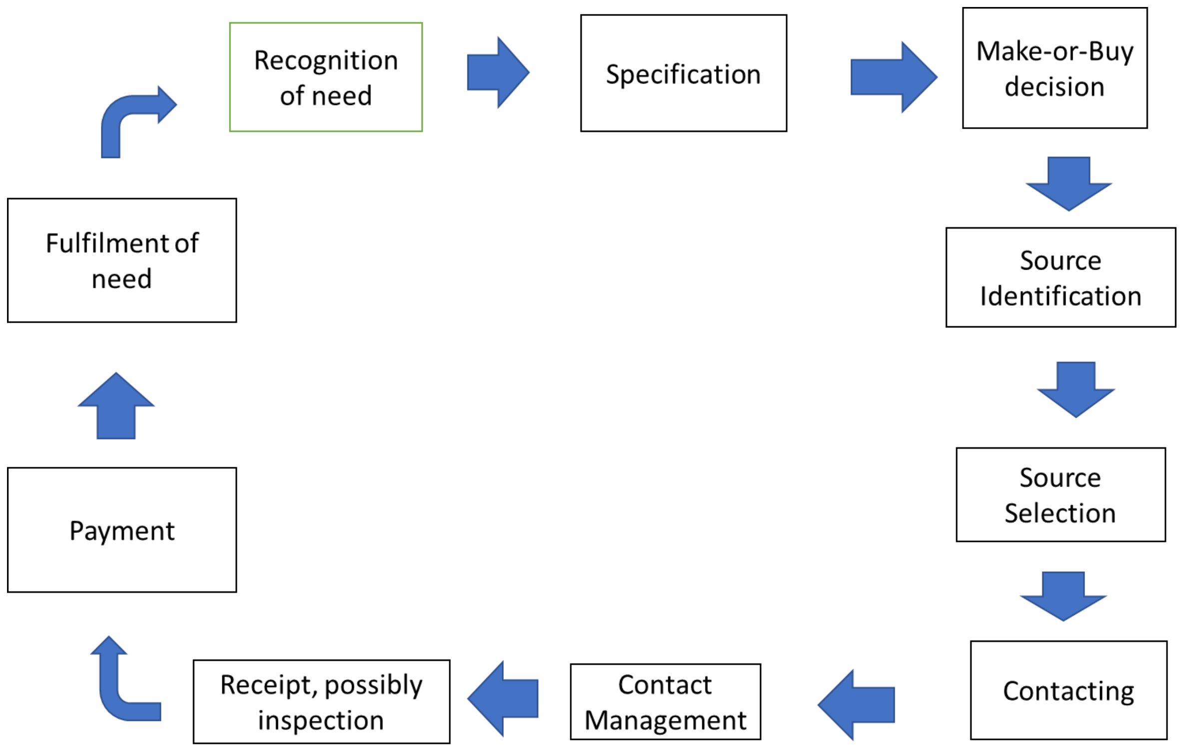


(Source: Adopted from baily, farmer, crooker, Jessop & Jone,2008)

In the first section of this paper, a critique would be made one how purchasing cycle is a commercial process, while the second part will illustrate the strategic importance and value of the purchasing process for procurement and supply in 2019 and in the future, lately a suitable conclusion will be drawn at the end of this paper

PURCHASING CYCLE AS A COMMERCIAL PROCESS

Purchasing is the series of steps taken by the organizational unit, which could be as a function or as part of integrated supply chain, it is responsible for procuring or helping users to procure, in an efficient manner, required suppliers at the right time, quality, quantity and price and the management of suppliers, which add to the competitive advantage of the organisation and attainment of its corporate strategy (Lysons & farrington, 2012).A purchasing process may to some extent change between companies and within organisations , for example, they may change depending on the type of purchase involve, which could be a new buy, a modified rebuy or a straight rebuy (Van Weele,2002), but there are some key components in the process that are continuous. Baily et al (2015) describes ten major steps in purchasing process with the of a diagram below



(Source: Adopted from baily, farmer, crooker, Jessop & Jone,2008)

Recognition of need

A purchasing need can be new or existing and this need can be recognized from various source such as customers requirement, internal request, supplier's suggestions and legal requirement (baily et al,2015).The formalization of organisation need have different term for product and services ,the need for product is term specification and the need for service is called statement of work(Chicksand et al,2012).The formalization of this need helps to better communicate need and helps in decision making (Cox,2014)

Specification

Specification can be classified into quality specifications, logistics specifications, maintenance specification, legal and environment requirements, lastly the target budget (Van Weele,2010). Supplier quality system is an important specification. The buying organisation wants to be convinced that the supplier can provide the product needed (Schiele,2012). Quality certification assist the buyer to a greater understanding of the quality condition of the organization and grow their confidence in the upcoming cooperation (Fayezi et al,2012). There are three quality management frameworks which are widely used. They are ISO 9000:2000, ISO14000, and the Malcolm Baldrige National Quality Award. ISO registration can be seemed as proxy evidence of supplier's quality capability (Monczka et al,2009). Van Weele (2010) defines logistics specification as related to the quantities needed, the place and time of delivery and the physical conditions of the goods. The physical shape to be respected also affect the quantity decision. For example, the purchased items can be solids, liquids or gases. Different handling, storage conditions, and purchase quantity rules are required if the material, size or shape is special or the purchased items are unstable, perishable or even dangerous (Leenders et al,2001).

Make or buy decision

In making a make or buy decision a contrast should be made between the cost of making in-house or buying in (baily et al.2015) The “make” option is recommended, in the case of services that obstruct the comparability of output and prices and lower market transparency. Further, asymmetric information generates adverse selection and moral hazard problems, emphasizing the role played by reputation (Jamali,2008). On the other hand, there are other arguments that favour the “buy” option. Among them are cost cut, increased capacity, improve quality, increase profitability and productivity, improve financial performance, lower innovation costs, risks, and improved organizational competitiveness, are very commonly considered as the main reasons to justify outsourcing strategies (Williamson,2008).

Source Identification

Lysons and Farrington (2006) illustrate that various sources of information help purchasers recognize potential source of supply. Suppliers can be located by checking comprehensive sources. It is a main source for the purchasing company to choose from., purchaser does not need to find new suppliers, it can save a lot of time. On the other hand, purchaser might already cooperate with existing suppliers and they are more familiar with each other. However, purchaser will never know whether there is better supply source, so using the current supplier is not the good approach for long-term (Monczka et al,2009). Steinle & Schiele (2008) point out that information database can help to provide latest information of suppliers. Companies can search the various databases and find out proper information which can meet their needs. Many companies have already achieved this by keep record of suppliers. The number of suppliers found defined the level of competition in the market.

Source selection

Based on the strategy options and various sources, the buyer creates a list of possible available suppliers. Adequate study must be given in deciding on the qualification of suppliers (Leenders et al, 2001). Several ways are used to evaluate and select the supplier from the companies which remain in the pool. It includes the methods of assessing the supplier provided information, supplier visits and using suppliers which are preferred by purchasers (Handfield et al,2009), After deciding on the supplier short list, the request for quotation (RFQ) will be sent out to the suppliers. Suppliers are asked to submit a bid to meet the requirements as itemized in RFQ so that the purchaser can differentiate bids among different suppliers. After that a balanced analysis of quotations is conducted in collaboration with the user, technical, logistic, quality, financial and legal aspects need to be weighted, usually with a method of ranking the suppliers (lewis & Harold,2009)

Contracting

According to Jonsson (2008) there are many types of contracts, for example, escalation clause, quantity flexibility, buy-back contract, sales rebate contract. Van Weele (2010) explains that technical contents in purchasing agreement rely on the project or product. Meanwhile, specific commercial and legal terms are different in different cases. Commercial regulations in the contract contain contract period, payment issues, and rules for handling changes, sanction clauses and agreements for disputes. The contract varies among different types of service, product, culture (Woolthuis et al,2005). There are mainly four kinds of price agreements in contracts. They are fixed price plus incentive, cost-plus contract, cost-reimbursable contracts and agreement with price adjustment (Cox,2014). Clauses in the contracts must be subject to the legal systems. It should be mentioned in the contract that the clauses should be used to ensure the good performance of products (Tulder Kolk,2001). It is also very important that supplier should take responsibility for the products delivered during certain period (Van Weele,2010).

Contract Management

In other to control stock and minimize waste, some companies decide on the order quantity of stock by choosing a method of Economic order quantities (EOQ), which is the quantity that results in lowest total of variable costs. For order quantity of production, material requirements planning (MRP), which schedules the end products to be completed week by week during the planning period, is used to calculate the quantities of components, subassemblies and material required to make complex products (Baily et al,2008). The ordering process can be enhanced through various way. For example, purchasers may sometimes issue blanket purchase order, an open order which is usually effective for one year, for routine purchases from one supplier. This reduces the time in order releasing and makes the ordering of material a routine process (Grossman & Helpman,2005).Online ordering system are also adopted in linking purchaser's and supplier's system electronically to faster order cycle time, reduce ordering errors, track order more efficiently and visualize back ordered items better (Monczka et al,2009)

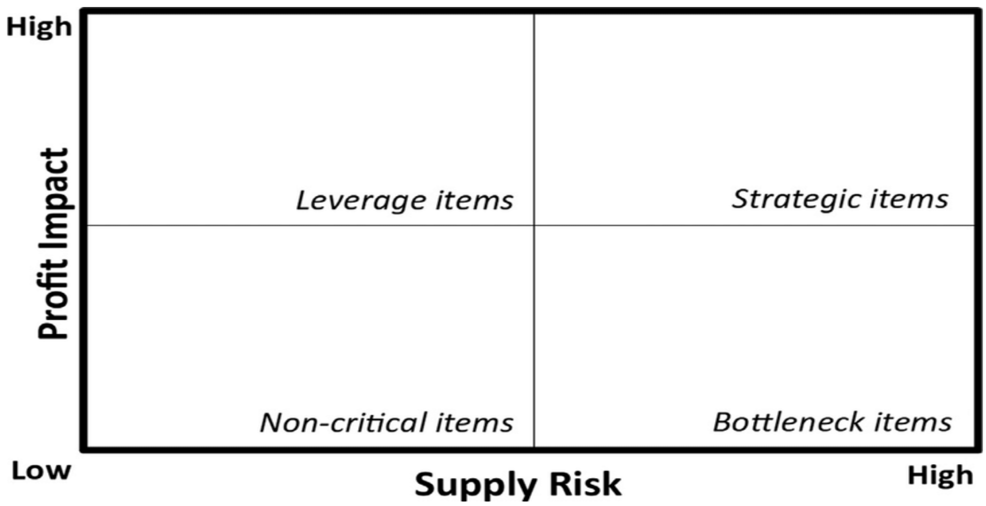
Receipt and possible inspection

When the product is received, all the arriving material is recorded and inspected in terms of quantity and quality (Harper,2010). Receiving and Inspection reports are issued if the products meet the requirement of purchaser, or else they will be refused .at the same time, an invoice will be provided from the supplier. If there is any lack of consistency between actual shipment and invoiced shipment, prompt adjustments must be done in order to clear payment within the discount period (Lin et al,2011).

According to Jonsson (2008), he argues that supplier inspection is the necessary step for considering the future partnership with suppliers. If suppliers perform well, the companies could add their name into the company's approval vendor list (Holger,2010). Based on the performance assessment, companies will gradually pay more attention in doing business with the vendors who get high performance rating scores (Van Weele,2010). Most assessment are done in two directions: effectiveness and efficiency. Measuring performance assist the buyer make better decisions. It can also promote the communication among supplier, buyer, and other departments. Meanwhile it can help the suppliers to enhance their performance. In addition, it also influences and guides the behaviour of supplier toward the desired direction (Monczka et al,2009)

Kraljic Purchasing Portfolio Model

According to van weele (2010), one of the most accepted and often used models to differentiate products and suppliers in order to find suitable purchasing strategies is a matrix developed by Kraljic (1983). The classification shows that there are different purchasing problems and those are divided in two dimensions. The first dimension illustrates the purchasing/supplier's effect on the financial result. If an organisation spends a lot of investments on purchasing of materials it means that the purchasing stage has a large impact on the profit of the company. Also, if the expenditures of materials are a great part of the total costs, therefore it means that a small change in the costs of materials leads to great effects on the profit margin. This dimension can be defined in terms of the volume purchases, percentage of total purchase cost or impact on product quality or business growth. The other dimension is the difficulty of the supply market. Kraljic (1983) describes it as risks that are associated with the product, which is assessed in terms of availability of the products, number of suppliers, competitive demand, make or buy opportunities, storage risks and substitution possibilities (Kraljic,1983). These two dimensions draw to a close that there exists a difference in option of strategy depending on what kind of product the company purchases (Faes & Matthyssens, 2009; Kraljic, 1983). For instance, are the products produced to the demand of the customer or are they standardised? Are the products of easy components or are they technically advanced? Does the supplier have a monopoly or oligopoly position on the market? By inspecting the products from these two dimensions, the organisation can classify all its purchased products into four categories: strategic, bottle neck, routine and leverage products. By doing this with the products it will also give a classification of the suppliers. The company will then be able to determine which type of purchasing strategy the company should follow for each specific product and supplier (Van weele,2010).



(Source: Adopted from van weele,2010)

Leverage products have a great impact on the profit because the products constitute a relatively high part of the total cost spent relative to the final product. A slight change in price will therefore cause a major effect on costs of the final product. Since these products can be bought from several sources the supply risk is low (Goebel et al,2003). Leverage products can be from the steel and aluminium industry, where one can buy standard products in a wide field of application (Axelsson,2001). For leverage products there are many competitors and commodity products. It is a buyer dominated segment, which means that the buyer has freedom of choice regarding the selection of suppliers (Sanchez, 2009). Abuse of this power, however, can lead to cooperation between the suppliers. Since the suppliers and products are replaceable, Kraljic (1983) recommend competitive biddings and no long-term supply contracts to be the best purchasing strategy. In this way the buyer will be capable of cutting the price. Buying at a minimum price, while maintaining the required quality level and continuity of supply, will take priority here (van weele,2010).

Routine products also classified as non-critical products. These products have a very low profit effect for the company and low supply risk (Ellegaard & Koch, 2012). Example of these products are office equipment, products the organisation needs for the everyday function (Kraljic, 1983). For routine products there is a large supply, therefore many suppliers with dependent position. The purchasing strategy should be to reduce the number of suppliers (Van Weele, 2002).

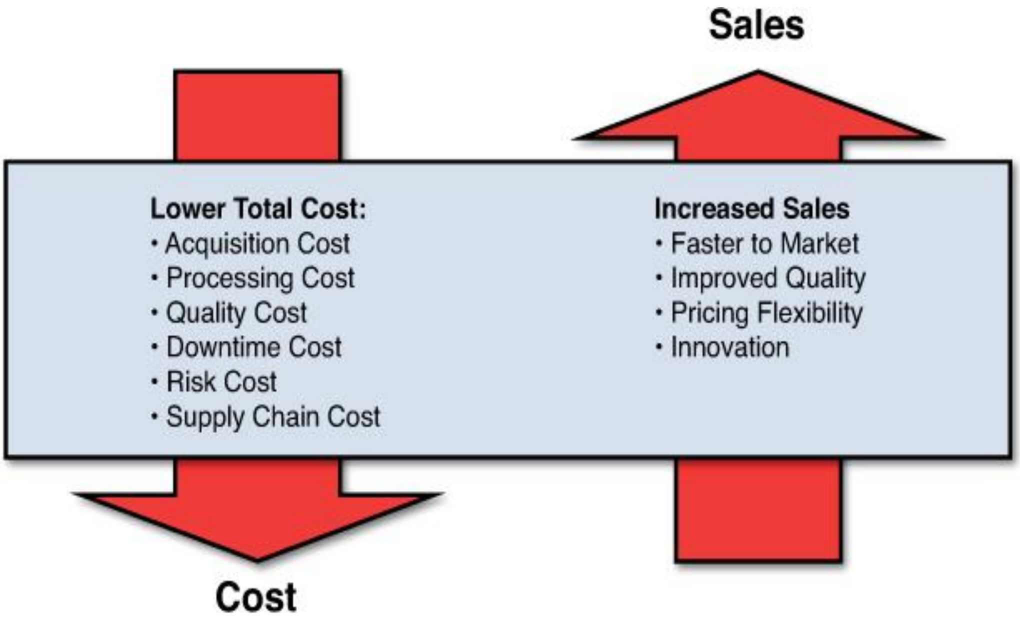
Strategic products have high profit impact and high supply risk, these products involve highly modify part that requires powerful technology (Cousins et at,.2006). Examples are engines and gearboxes for automotive manufacturers (Kraljic, 1983). For strategic products the suppliers are market leaders and possess knowledge. Only a single source of supply is available, which cannot be changed in the short term without experiencing significant costs. The purchasing strategy for strategic products will be aimed at partnership or collaboration. These partnerships often have a high mutual dependence between the parties involved. There should be an intensive communication and interaction (Caniëls & Gelderman 2005).

Bottleneck products are products that have little or no profit impact and high supply risk (Kraljic, 1983). Axelsson (2001) defines them as being sensitive for disruptions in delivery. An example of this category of product are the colour pigment used by colour manufacturer, which is included in the paint to make different colours. For bottleneck products the suppliers are technology leaders and there not much, if any, it will be an alternative supplier. Hence bottleneck products are identified as a supplier dominated segment (Cousins et al,2008). The purchasing strategy should be to secure continuity of supply, if needed, at additional cost. One should also aim to develop alternative products and suppliers in order to reduce dependence on these suppliers (Van weele, 2010; Kraljic 1983).

Strategic importance and value of the purchasing process in procurement and supply

Efficiently managing the purchasing process enables organization to grasp immediate upfront cost savings by purchasing product, services, and contracts at the best price (Wynstra et al,2003). A fully functional purchasing process will enable better visibility of the organisational spending and budgets (Jacques & Alannah,2003). Having a robust knowledge of company spending, this will allow organizations to negotiate better contracts with vendors, enabling a company to take full advantage of reduction that might have previously appeared unavailable to them. Visibility into spending patterns and budgets will also give organizations the option to leverage extra cash flow by increasing payment terms and forecast for the future (Caridi et al, 2013).

As recently identify, purchasing is seen as having a huge effect on the bottom line of a firm. It has a direct influence on the two forces that drive the bottom line: sales and costs (tate,2014).



(Source: adopted from tate,2013)

The effect on net income and return on investment (ROI) have a significate impact on shareholder value. The cost effect is easily shown because cost reduction is in most cases considered a “purchasing job.” Purchasing works with internal customers to help the processes and reduce costs. Purchasing also work with suppliers to improve processes, look at alternative materials, different locations or transportation modes. Focusing on cost improvement is a core capability of a purchasing managers (Tate,2013).

An optimized purchasing process will lead to greater efficient sourcing of quality items and services delivered on time (Allen & Chandrashekar,2000).An up to date purchasing process will also ensure that an organization’s supply chain will be in position to steer through any unforeseen barriers (financial issues, natural disasters, employee shortage/surplus, economic unpredictability) (Fulton & Lee, 2013).When optimized, an efficient purchasing process will also help in distinguishing between successful vendors from underachieving vendors, being able to choose between quality vendors will not only improve your supply chain overall but might even lead to compensation from the low-quality vendors from failing to deliver within agreed upon specification (Mol et al,2004).

organisations are always being competitive with their competitors on price, quality of good or service, or convenience (Schoenherr,2012). Any competitive advantage could be the distinction between a new customer and lost sale. A company with an assign purchasing process will help the sourcing of the innovative goods and services in the hopes of securing a competitive advantage. In some cases, solidifying the function could provide exclusive deals with suppliers (Bemelmans,2013).

CONCLUSION

The general traditional understanding lies the disagreement that purchasing is not strategically important for a firm to earn competitive edge (Schoenherr,2012), but the disagreement is seen as unprofane since purchasing is getting great significance in the academia and business environment (Bemelmans et al,2013). The necessity for cutting down costs, development of value-added in business, better bottom line has caused the increase in importance of purchasing to the performance of a company (Lysons & farrington,2012). over the years, purchasing has developed from a reactive, transactional state of procuring supplies to a strategic, unsegregated state that centre proactively on the total fulfilment of both internal and external customers of a company (baily et al,2008). Although, sourcing out requires effective supplier relationship management. Purchasing in position to select suppliers that with work jointly in achieving the organisation’s competitive strategy (van weele,2010). Purchasing is also capable of using tools and techniques like e-procurement and total cost of ownership approach next to their ability to control purchasing costs and balance power dependence between the company and supplier as well as finding out strategies to collaborate with different suppliers (Faes et al,2009). In the absence of a given strategic importance of purchasing process, a firm’s opportunities of gaining competitive advantage might not be achieved (baily et al,2008)

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