Purchasing Management

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Overview

- What do you mean by purchasing?

Overview

- Purchasing – act of obtaining merchandise, capital equipment, raw materials, services or maintenance, repair and operating supplies in exchange for money or its equivalent.

- Two categories
  - Merchants
    - Ad - volume discounts, transportation economy, storage efficiency
    - Create value – consolidating merchandise, breaking bulk, providing essential logistical services
  - Industrial buyers – RM for conversion purpose
    - Manufacturers, restaurants, florists

Role of Purchasing in an Organization

- **Significant**
  - US manufacturing sector - 50% of each sales dollar spent for purchasing
  - Value spending for purchasing is some time higher than the value added through manufacturing
  - Wal-Mart – 78% of its net sales represent the money spent for purchasing

- **Primary goal(s)**
- What is the primary goal(s) of purchasing?

- **How to achieve the objectives?**

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- **Primary goal(s)**
  - Uninterrupted flows of raw materials at the lowest total cost, to improve quality of the finished goods produced, and to optimize customer satisfaction.
- **How to achieve the objectives?**
  - Seek better materials,
  - Reliable suppliers,
  - working closely with and exploiting the expertise of strategic suppliers to improve the quality of RM
  - Get involvement in new product design and development efforts

The Purchasing Process

- Draft the manual process of purchasing in a company/organization

The Purchasing Process

- Manual process
- Electronic process - result of EDI
- Advantages
- Time savings
  - Selecting and maintaining a list of potential suppliers
  - Processing requests for quotation and PO
  - Making repeat purchases
  - Automatic bidding
- Cost savings
- Accuracy
- Real Time
- Mobility
- Tractability
- Management - store important suppliers' information
- Benefits to the suppliers

Small Value Purchase Orders

- Extra burden to purchasing managers - Administrative costs and order cycle time
- What strategies can be implemented to overcome these issues?

Small Value Purchase Orders

- Extra burden to purchasing managers - Administrative costs and order cycle time
- Alternatives
  - **Procurement credit cards/Corporate purchasing cards**
  - **Blank Cheque Purchase Orders**
  - **Blanket or Open-End Purchase Orders** – covers a variety or items and is negotiated for repeated supply over a fixed time period such as quarterly or yearly
  - Open-end PO – additional items and expiration dates can be renegotiated.
  - **Stockless Buying or System Contracting** – suppliers should maintain the minimum inventory level
  - **Petty cash**
  - **Standardization and Simplification of Materials and Components**
  - **Accumulating and Small Orders to Create a Large Order**
  - **Using a Fixed order interval for specific categories of materials/supplies**

Sourcing Decisions: The Make-or-Buy Decisions

- Outsourcing – buying materials and components from suppliers instead of making them in-house.
- In past – prefer make option using backward or forward integration
- Not all functions can be outsourced – mostly core in in-house
- **Reasons for buying or outsourcing**
- **Reasons for making**

Sourcing Decisions: The Make-or-Buy Decisions

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- **Reasons for buying or outsourcing**
  - Cost advantages
  - Insufficient capacity
  - Lack of expertise
  - Quality

- **Reasons for making**
  - Protect proprietary technology
  - No competent supplier
  - Better quality control
  - Use existing idle capacity
  - Control of lead-time, transportation and warehousing cost
  - Lower cost

Make –or-Buy Break-Even Analysis

- Annual requirements = 15,000 units
- Cost

Cost	Make Option	Buy Option
FC	$25,000.00	$500,00
VC	$5.00	$7.00

BE

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BE

TC to make = TC to buy

BEQ = 12250

TC at BE option = 25,000.00 + 5 x 12,250 = $86250

TC for making = 500 + 5 x 15000 = $87250

TC for buying = 25000 + 7 x 15000 = $105500

Role of Supply Base

- Strategic Role of suppliers
- Suppliers not only provides products/supplies but also;
  - Product and process technology and knowledge to support the buyer's operations, particularly in product design – supplier involvement
  - Information on trends, processes, designs
  - Information on supply market – shortages, price increases, political situations - may threaten supplies of vital materials
  - Capacity for meeting unexpected demand
  - Cost efficiency due to economies of scale, since the supplier is likely to produce the same item for multiple buyers

Supplier Selection

- What are the factors considering when selecting suppliers?

Supplier Selection

- Factors considering
  - Product and process technologies
  - Willingness to share technologies and information
  - Quality
  - Cost
  - Reliability
  - Order system and cycle time
  - Capacity
  - Communication capability
  - Location
  - Service

How many suppliers to use?

- **Reasons for favouring single supplier**

- **Reasons for favouring more than one supplier**

How many suppliers to use?

- **Reasons for favouring single supplier**
  - To establish a good relationship
  - Less quality variability
  - Lower cost
  - Transportation economies
  - Proprietary product or process purchase
  - Volume too small to split
- **Reasons for favouring more than one supplier**
  - Need capacity
  - Spread the risk of supply interruption
  - Create competition
  - Information
  - Dealing with special kinds of businesses

Purchasing Organization: Centralized vs Decentralized purchasing

- **Advantages of centralization**

Hybrid Purchasing Organization

- **Advantages of decentralization**

Purchasing Organization: Centralized vs Decentralized purchasing

- **Advantages of centralization**
  - Concentrated volume
  - Avoid duplication
  - Specialization
  - Lower transportation costs
  - No competition within units
  - Common supply base
- **Advantages of decentralization**
  - Closer knowledge of requirements
  - Local souring
  - Less bureaucracy

Hybrid Purchasing Organization

International Purchasing/Global Sourcing

- Provide opportunities to improve
  - Quality
  - Cost
  - Delivery performance
- Need additional skills and knowledge to deal with international suppliers, logistics, communication, political and other issues – tariff and non-tariff barriers
- Variety of Options
  - International purchasing office
  - Import broker or sales agent – do not take title to the goods
  - Import merchant – buy and take title to the goods
  - Trading company – a wide variety of goods

Reasons for Global Sourcing

- Why do companies source globally?

Reasons for Global Sourcing

- Lower price
- Better quality
- Overseas supplier holding the patent to the product
- Faster delivery to foreign units
- Better services
- Better process or product technology

Potential challenges for global sourcing

- Global sourcing increased due to improvement of communication and transportation technologies, reduction of internal trade barriers, deregulation of transportation industry

- What challenges are involving in global sourcing?

Potential challenges for global sourcing

- Global sourcing increased due to improvement of communication and transportation technologies, reduction of internal trade barriers, deregulation of transportation industry

- Complexity and cost involved in
  - Selecting foreign suppliers
  - Dealing with duties, tariffs,
  - Custom clearance
  - Currency exchange
  - Political, labor and legal problems

Countertrade

- In which goods and/or services of domestic firms are exchanged for goods and/or services of equal value or in combination with currency from foreign firms
- Barter – complete exchange of goods and/or services of equal value without the exchange of currency
- Offset- an exchange agreement for industrial goods and /or services as a condition of military-related export
- Direct offset – usually involves coproduction, or joint venture, and exchange of related goods and/or services
- Indirect offset – involves exchange of goods and/or services unrelated to the aerospace or defense sector
- Counterpurchase – arrangement whereby the original exporter either buys or finds a buyers to purchase a specified amount of unrelated goods and/or services from the original importer