

**PURCHASING STRATEGY,
PLANNING AND
POLICIES**

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By

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Overview of Purchase

- What is Purchasing (Supply Chain)
 - Importance of Purchasing
 - Average Purchase Cost
 - Objectives of Purchase Function
 - Purchase Focus
 - Traditional Purchasing Process
- Overview of Purchase Strategy
- Understand Your Organization
- Best Practice
- Purchasing Plan
- Continuous Improvement in Purchasing Strategy
- Criteria for Good Purchasing Excellence
- Effect of Good Purchasing Policies

What is Purchasing

- Planning, organizing, directing, & controlling in-flows of materials into a system for value addition (manufacturing or service). Purchasing
 - Begins with acquisition of raw materials, consumables etc
 - Continues through internal operations
 - Ends with distribution of finished goods
- Involves everyone in supply-chain
- Objective: Maximize value & lower waste
- A **strategy** is a plan of action designed to achieve a particular goal.

Importance of Purchasing

- Major cost center in an organization
- Affects quality of final product
- Aids strategy of low cost, response, and differentiation

Average Purchase Costs as a Percent of Sales

•Industry

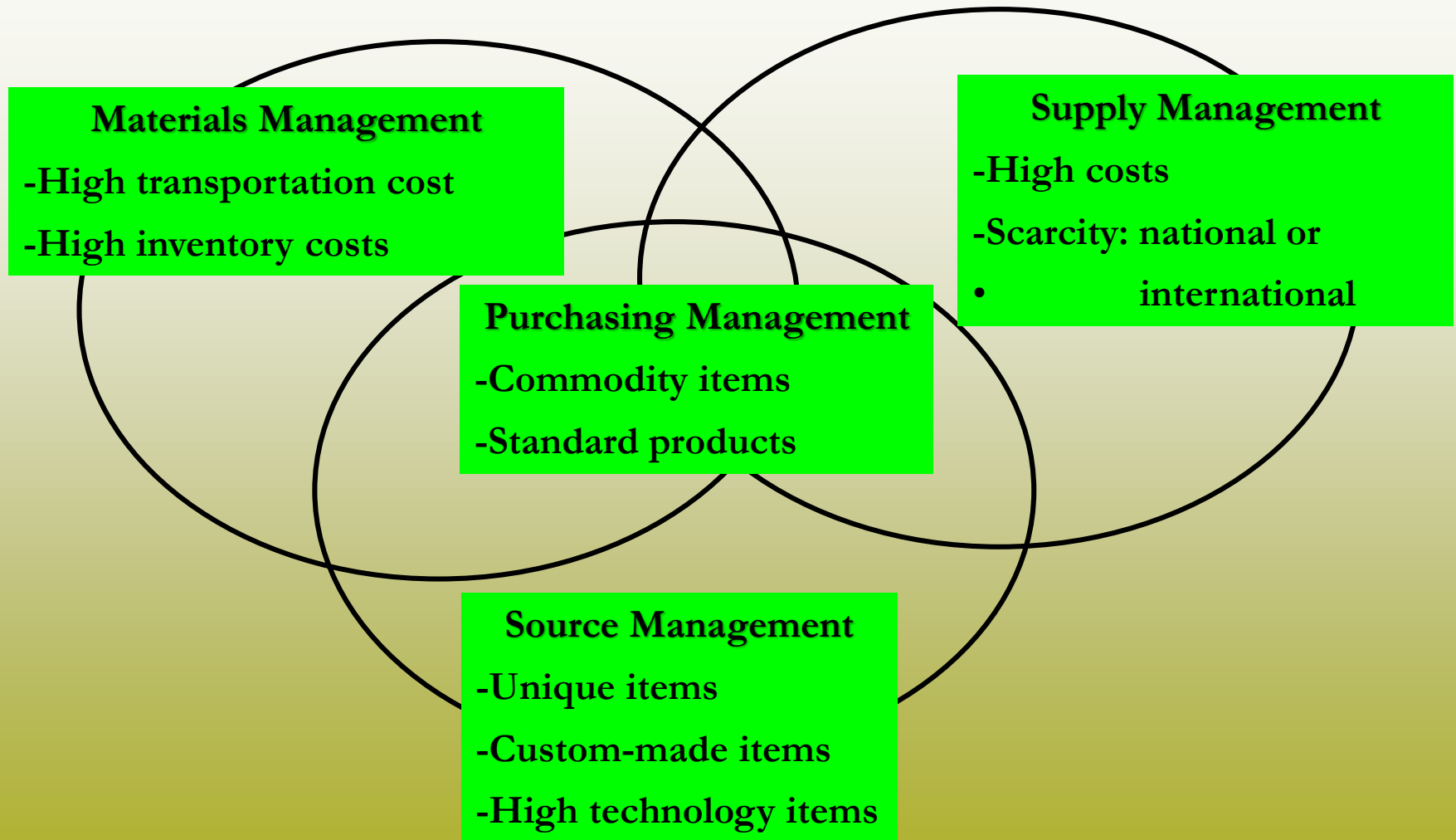
•Percent of Sales

□ All industry	□ 52%
□ Automobile	□ 67%
□ Food	□ 60%
□ Lumber	□ 61%
□ Paper	□ 55%
□ Petroleum	□ 79%
□ Transportation	□ 62%

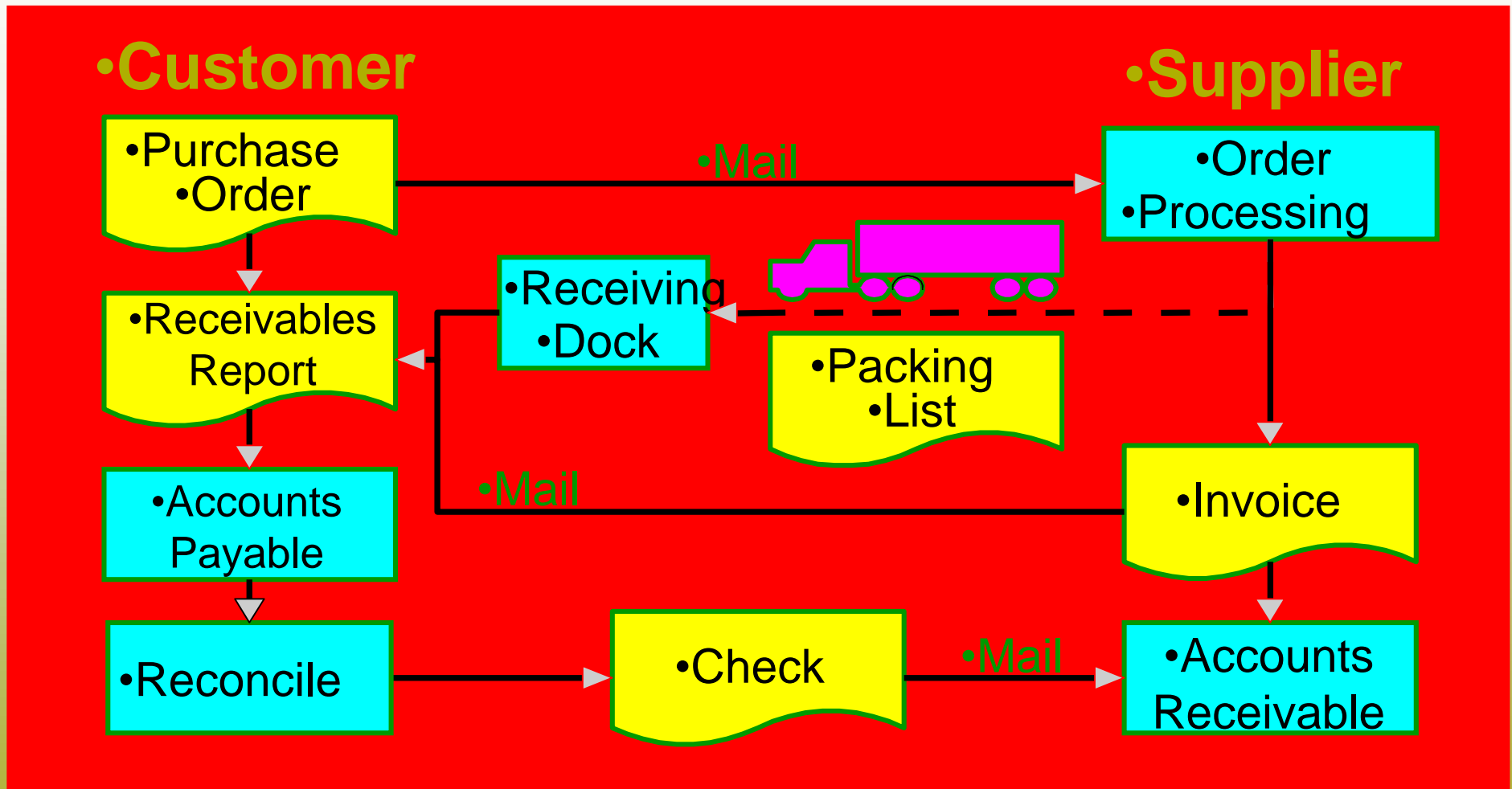
Objectives of the Purchasing Function

- **Help identify the products and services that can be best obtained externally as against production in-house**
- **Develop, evaluate, and determine the best supplier, price, and delivery for those products and services**

The Purchasing Focus



Traditional Purchasing Process



OVERVIEW OF PURCHASING STRATEGY

Strategy

- A strategy is a plan of action designed to achieve a particular **goal**.
- Allocation and management of sufficient resources (financial, personnel, operational support, time, technology support)
- Establishing a chain of command or some alternative structure (such as cross functional teams)
- Assigning responsibility of specific tasks or processes to specific individuals or groups
- It also involves managing the process. This includes monitoring results, comparing to benchmarks and best practices, evaluating the efficacy and efficiency of the process, controlling for variances, and making adjustments to the process as necessary.
- When implementing specific programs, this involves acquiring the requisite resources, developing the process, training, process testing, documentation, and integration with (and/or conversion from) legacy processes.

GOAL OF PURCHASING STRATEGY

- To improve product /service quality i.e. producing defect-free products and materials
- Improves risk management which is inherent in external and internal environment
- Product improvement thereby reducing product, processes and channel costs
- Improvement in technological development through increased technical and technological superiority
- Increasing the velocity of transaction thereby exploiting time for competitive advantages
- **Promoting good purchasing strategy/practices will ensure:**
 - That value for money is achieved through the efficient use of resources
 - That total purchase cost is managed appropriately
 - That purchasing power is maximized
 - That risk is minimized
 - That legal requirements are adhered to
 - That best practice is met, and exceeded where possible

Factors Influencing Purchasing Strategy

- Sophistication of the Corporate Planning Processes
- Degree of dependence of the organization on purchased products and services
- Top management perception and support for the purchasing functions and departments
- Availability of technology enablers
- State of the evolution of purchasing functions
- Integrity of the personnel

THESE SERVE TO ACHIEVE THE FOLLOWING:

- Order Management (navigation of the supplier order through inventory allocation, picking and storage while accessing the back order cycles)
- Production Procurement (optimization of supplies to multi channel users)
- Freight cost & Services Management (sorting out the in bound/out bound freights, carrier management, and other cost controls)
- Warehouse Management (material handling, storage, utilization, put-aways and returns)
- Transportation routing (optimization of shipping capacity utilization, postponement strategies, third party transportation etc)

Supply-Chain Strategies

- **Negotiate with many suppliers; play one supplier against another**
- **Develop long-term “partnering” arrangements with a few suppliers who will work with you to satisfy the end customer**
- **Vertically integrate; buy the actual supplier**
- **Keiretsu (Japanese Mgt Word) - have your suppliers become part of a company coalition**
- **Create a virtual company that uses suppliers on an as-needed basis.**

Many Suppliers Strategy

- Many sources per item
- Adversarial relationship
- Short-term
- Little openness
- Negotiated, sporadic Price Offerings
- High prices
- Infrequent, large lots
- Delivery to receiving dock



Few Suppliers Strategy

- 1 or few sources per item
- Partnership (JIT)
- Long-term, stable
- On-site audits & visits
- Exclusive contracts
- Low prices (large orders)
- Frequent, small lots
- Delivery to point of use



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Purchasing Techniques

- **Drop shipping and special packaging:** Supplier will supply to end consumer rather than to re-seller
- **Blanket orders:** A long-term purchase commitment to a supplier for items that are to be delivered against short-term releases
- **Invoiceless purchasing:**
- **Electronic ordering and funds transfer**“Paperless” ordering and 100% material acceptance, payment by “wire”
- **Electronic data interchange (EDI)**
- **Stockless purchasing: JIT**
- **Standardization:** Reducing the number of variations in materials and components
- **Outsourcing**

Supplier Selection Criteria

□ **Company**

- **Financial stability**
- **Management**
- **Location**

□ **Product**

- **Quality**
- **Price**

□ **Service**

- **Delivery on time**
- **Condition on arrival**
- **Technical support**
- **Training**

Understand Your Organization

- **Learn organization functions**
- **Understand departmental functions and their needs in terms of goods & services**
- **What is crucial to each manager in terms of quality, price, and delivery**
- **Which items they purchase most**
- **Gather as much data as you can to provide a sound basis for formulating strategy**

Purchase History

- Use purchase orders & requisition to compile purchase history
- Gather data on product types, order quantities, lead times, pricing, order frequency, etc
- Use this information to construct a purchasing history for key items

Proactive Purchasing

- Use long term requirements to negotiate volume discounts
- Anticipate re-order dates and initiate necessary groundwork
- Reduce delivery charges by ordering like quantities at the same time
- Arrange for suppliers to stock frequently used items free of charge, thus reducing your storage requirements, controlling lead times, & giving you benefits of bulk purchase
- Monitor price fluctuations & seasonal trends and use them to hedge against adverse effects on your organization.

BEST PRACTICE IN PURCHASING MANAGEMENT

- **Establish Code of Ethics**
 - **Respect suppliers' confidentiality**
 - > **Don't disclose their prices & trade secrets to their competitors**
 - **Declare any personal interest**
 - **Its good practice not to accept gifts from suppliers or potential suppliers**
 - > **Advice all suppliers on this in writing at the beginning of the relationship**
- **Protect yourself**
 - **If you have a roll-over contract, make sure you know when you have to give notice if you have to terminate**
 - **Be aware of the limits on your authorities, and don't exceed them**
 - **Never make assumptions – clarify all details in writing – specifications, etc.**
- **Keep your Side of the Bargain**
 - **Ensure that your organization pays suppliers in accordance with your agreements and terms of engagement**

PURCHASING PLAN

- **Planning is a process for accomplishing purpose. It is blue print of business growth and a road map of development. It helps in deciding objectives both in quantitative and qualitative terms. It is setting of goals on the basis of objectives and keeping in view the resources.**
- **What should a plan be? A plan should be a realistic view of the expectations. Depending upon the activities, a plan can be long range, intermediate range or short range. It is the framework within which it must operate.**

Good Purchasing Plan achieves the following purposes

- Reduces Channel Costs:**
- Reduces Lead Time**
- Reduces Inventory**
- Increases Customer Response and Flexibility**
- Improves material handling**
- Provides Uninterrupted Flow of Materials**
- Purchases Items Competitively**
- Develops Supplier base**
- Reduce costs together with suppliers**

Make/Buy Considerations

• Reasons for Making

1. **Maintain core competencies and protect personnel from layoff**
2. **Lower production cost**
3. **Unsuitable suppliers**
4. **Assure adequate supply**
5. **Utilize surplus labor and make a marginal contribution**

Reasons for Buying

1. **Frees management to deal with its primary business**
2. **Lower acquisition cost**
3. **Preserve supplier commitment**
4. **Obtain technical or management ability**
5. **Inadequate capacity**

Make/Buy Considerations - Continued

• Reasons for Making

6. Obtain desired quantity
7. Remove supplier collusion
8. Obtain a unique item that would entail a prohibitive commitment from the supplier
9. Protect proprietary design or quality
10. Increase or maintain size of company

Reasons for Buying

6. Reduce inventory costs
7. Ensure flexibility and alternate source of supply
8. Inadequate managerial or technical resources
9. Reciprocity
10. Item is protected by patent or trade secret

SUPPLIER RELATIONSHIP MANAGEMENT SRM

- SRM is the creation of cooperative alliances formed to exponentially expand the capabilities and opportunities in material requisition, procurement procedures and efficiencies, deliveries and product information exchange.
- The goal is to transform suppliers from adversaries into up stream channel partners when they act more like arm of the procurement organization
- This creates a win-win situation for both parties

Tactics for Close Supplier Relationships

Tactic

- Reduce total number of suppliers
- Certify suppliers
- Ask for JIT delivery from key suppliers
- Involve key suppliers in new product design
- Develop software linkages to suppliers

Results

- Average 20% reduction in 5 years
- Almost 40% of all companies surveyed were themselves currently certified
- About 60% ask for this
- About 54% do this
- Almost 80% claim to do this
About 50% claim this

Traditional Approach Vs SRM

Traditional Approach	SRM
Adversarial relationship	Collaborative relationship
Many competing suppliers	Small core of supply partners
Contracts focused on price	Contract on long term quality & mutual benefits
Proprietary product information	Collaborative sharing of information
Evaluation by bid	Evaluation by commitment
Suppliers excluded from design process	Real time design communication
Process improvement intermittent & unilateral	Close linkages for design and improvement
Quality defects reside with the supplier	Mutual responsibility in design

CONTINUOUS IMPROVEMENT IN PURCHASING STRATEGY

In meeting its strategic objectives, the Purchasing Dept should have the following action plan and continuously develop, adapt and adopt them:

- Continue to develop a professional, competent team with a comprehensive understanding of processes, a thorough knowledge of the organization and the ability to develop sound long-term supplier relationships.
- Provide advice, guidance and support to depts and units on purchasing issues.
- Ensure provision of clear audit trails and strict adherence to guidelines on ethical purchasing.
- Ensure early involvement in key processes and better visibility through sharing of information.
- Measure supplier performance and provide feedback enabling ongoing communication, continuous process improvement and supplier development.
- Analyse and benchmark procurement processes to measure the performance and effectiveness of the purchasing function, remove non-value-added activities, reduce administration costs and ensure value for money.
- Develop and revise, depending on need, training programmes for all staff involved in purchasing.

CONTINUOUS IMPROVEMENT PURCHASING STRATEGY CONT'D

- Ensure compliance with public procurement legislation and best practice by developing, reviewing and updating purchasing guidelines, regulations and procedures.
- Initiate, operate and maintain dedicated purchasing initiatives and arrangements for use throughout the organization, whilst encouraging collaboration and aggregation where possible.
- Develop relationships with regional and national consortia, other similar organizations – participating in working groups and sharing expertise where appropriate.
- Ensure the provision of a purchase order processing facility which meets the needs of all departments.
- Develop the e-procurement facilities through the implementation of a full on-line purchase-to-pay solution.
- Implementation of the Efficiency Measurement Model (EMM) to measure activity and identify areas of efficiency gains.
- Review of procedures governing inventory management, including the roles and responsibilities of Inventory Officers, and produce a proposal, with recommendations, for further consideration within the organization.
- Continuous training in statistical quality techniques, problem solving, value analysis and cohesive team building.
- Guide resources allocation in response to new business opportunities & challenges.

CRITERIA FOR GOOD PURCHASING EXCELLENCE

- LEADERSHIP**
- STRATEGIC PLANNING**
- SUPPLIERS AND MARKET FOCUS**
- INFORMATION ANALYSIS**
- HUMAN RESOURCES**
- PROCESS MANAGEMENT**
- BUSINESS RESULT AND FEEDBACK**

EFFECTS OF GOOD PURCHASING POLICIES

- **Higher Profit**
- **Higher EPS**
- **Revenue Growth**
- **Return on invested capital**
- **Lower Production/Service Cost**
- **Efficient Assets Utilization**
- **Satisfactory Workforce**
- **Good relations with suppliers**



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