

Principles of Purchasing

Lecture 1

Introduction to Principles of purchasing

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Lecture Learning outcomes

At the end of the lecture, you will be able to:

1. *Explain the function and objectives of purchasing*
2. *Explain the purchasing procedures*
3. *Describe how the organization can do proactive purchasing*

1.1 Introduction to principles of purchasing

Procurement is the process of obtaining goods or services in any way, including borrowing, leasing and even force or pillage (Lysons and Farrington, 2007).

Purchasing can be defined as a process of acquiring goods, services, or works in return for a price. The major type of activities under purchasing function entail: coordination with user departments to identify purchase needs, identification of potential suppliers, conduct of market studies/survey for important materials, negotiation with potential suppliers, analysis of proposals, selection of suppliers, issuance of purchase orders, administration of contracts and resolution of related problems and lastly maintenance of a variety of purchasing records.

Purchasing activities

Purchasing activities involve buying decisions to ensure that: the right goods are in the right place, at the right time, at the right price, at the right quality and at the right quantity. These are sometimes referred to as the six R's of purchasing.

- a) *The right goods*: In regard to this, the buyer specifies exactly what the organization requires (based on the needs) rather than simply buying from catalogue or what is on offer

- b) *The right place:* In making the buying decisions it is important to provide detailed instructions on how, when and where deliveries are to be made.
- c) *The right time:* This is an attribute of ensuring that the ordered item reaches the company at the stipulated time to facilitate efficient supply chain operations.
- d) *The right price:* Achieving the right price is an important task since this will affect the purchaser's cost structure and ultimately the margin achieved (profitability).
- e) *The right quality:* The customer either specifies quality or expects the supplier to do so. The bottom line here is that the goods to be supplied should meet the user's standards
- f) *The right quantity:* This entail fully supply of the ordered items. For instance if the buyer orders ten units then the supplier should exactly deliver the specified units that are ten.

What are the Objectives of Purchasing department?

The objectives of purchasing can be outlined as follows:

- **Maintaining continuity of supply:** The purchasing function must ensure the continuous availability of material, supplies and equipments to maintain production schedule or to avoid disruption in production. The purchasing function also requires investments in reserve inventories. The efficiency of purchasing function lies in proper balancing of these factors which require experience, judgment of future activities and trends and various other activities on the part of purchasing authority.
- **Maintenance standards quality:** The purchasing function must ensure that the material purchased must be of required quality in order to produce the goods according to specifications and to maintain quality standards.
- **Avoidance of duplication, waste and obsolescence:** The purchasing authority must have the accurate knowledge of the items in hand and the requirements of materials for a particular period in order to have proper decision in view of long range and short range plans. This is necessary to avoid duplication, waste and obsolescence with respect to various items purchased.
- **Maintenance of company's competitive position:** The purchasing authority must constantly examine his specifications for the purchase of right material. This is necessary to make sure that his

company's quality standards are neither higher nor lower than those of close competitors and to maintain his company's position in the industry.

- **Maintenance of company's good image:** The purchasing agent must create a good image in the minds of suppliers. This will help him in purchasing operation and to discover new ideas and materials besides lowering its cost or improving products.
- **Developing alternative sources of supply:** Alternative sources of supply should be exposed for increasing the bargaining power of the buyer and minimizing the cost of purchases. Purchases can be made from alternative sources if a particular supplier fails to supply the required items

Purchasing procedures

Apart from pre-purchase activities such as participation in the preparation of specification and budget decisions, purchasing has traditionally involved three main phases, each involving specific documents and considerable clerical activity.

(a) The identification phase:

This involves the notification of the need to purchase by either:

- ✓ A requisition issued by the stores department
- ✓ A bill of materials (BOM) issued by the drawing office or production control department
- ✓ Requirement from user departments.

(b)The ordering phase:

On the receipt of the requisition or bill of materials, the buyer will check them for accuracy, conformity to specifications and purchase records to ensure whether the purchase is a re-buy or a new buy request. If it is a re-buy request previously purchased from satisfactory supplier at an acceptable price, a repeat order may be issued.

If however, the item is anew purchase request, the traditional steps will be involved as follows:

- (i) Enquiries will be sent to possible suppliers accompanied by additional documents e.g. drawings, specifications etc which will enable the suppliers to quote.

- (ii) Quotations will be received in response to the enquiries and compared with respect to price, quality, delivery, tool costs etc and terms of business.
- (iii) When quantities are sub-station and quality/delivery are of great importance, further negotiation with suppliers including an evaluation of their capacity to undertake the order may be required.
- (iv) A purchase order will be issued to the vendor. The quotation should be amended thoroughly in line with the negotiation between the buyer and the supplier.
- (v) An order acknowledgement should be required from the vendor which should be examined by the buyer to ensure that the order has been accepted on the terms and conditions agreed.

(c)The post-ordering phase:

- ✓ It may be necessary to progress the order to ensure that delivery dates are met or to expedite delivery of overdue orders.
- ✓ The supplier will issue an advice note, notifying the buyer that goods have been dispatched or are ready for collection.
- ✓ On receipt, the goods will be checked for quantity by the stores, matters of quality or specifications will be examined by the inspection department.
- ✓ An invoice for the value of goods will be received from the supplier. The purchasing department will pay special attention to the legitimacy of any variations from the quoted price and if satisfactory, the invoice will be passed to accounts department for payment.
- ✓ On completion, the order will be transferred to a completed orders file.

Buying strategies for small orders, emergency orders, and bulk purchases:

It is estimated that about 60% of the purchasing and accounts payable transactions often represent only 5% of the total value of purchase expenditure. Low value orders therefore both increase costs and hamper both purchasing and accounting productivity. A low cost system is therefore required for the efficient handling of low value purchases. Such systems include:

- (a) ***Telephone orders:*** The buyer passes all the requirements via the telephone conversation to the supplier and provides an order number.

- (b) **Procurement cards:** These are similar to consumer credit cards and involve a provider such as master cards, visa etc. Such cards relieve purchasing staff from purchase order preparation.
- (c) **Petty cash purchases:** Items bought are paid for at once from petty cash. The main problem in this case is controlling the number and size of purchases.
- (d) **Standing orders:** Entail submission of an invoice of agreed intervals.
- (e) **Blanket orders:** Encompass all orders for a range of items placed with one supplier for a specified period. User's call off required items directly from the supplier through telephone, fax etc and the amount due is summarized by the supplier as a single invoice. This attribute is convenient for making bulk order to gain economies of scale.
- (f) **Electronic Data Interchange (EDI):** This can include linkages for information exchange, order payment and can be easily combined with blanket ordering.
- (g) **Blank-cheque orders:** In this case the blank cheque is attached to the order form and sent to the supplier. On forwarding the goods, the supplier fills the cheque and deposits in his accounts
- (h) **Placement for own orders:** The users are authorised to raise own orders and sent to suppliers in areas where purchasing function expertise is not required.

Proactive procurement:

Proactive procurement can be defined as a strategic way based on advocating for control of all overall acquisition of goods/services for a company rather than reactive way of approaching buying activities. It puts emphasis on long range relationship negotiation activities, expanding the supplier's and material's total cost, instead of doing it in repeated demands and stock reposition, early purchase involvement, purchase specifications etc.

Proactive procurement procedure entails:

- ✓ Making sure of purchasing continuity to keep effective relationships with existent sources, developing other supply alternatives, or attending the emergent or planned necessities, selecting the best suppliers.

- ✓ Keeping solid and cooperative relationships with the other organizational functions, supplying necessary information, and advising to make sure of the effective operation of the entire organization.
- ✓ Developing the training of employees, and the adoption of procedures organization to make sure to reach the previous goals.
- ✓ Keeping a balance between quality and value, obtaining products and services in the necessary quantity and quality for the lower cost.
- ✓ Surveying market tendencies.
- ✓ Developing methods to negotiate purchasing conditions to deal with suppliers that look for mutual benefit by means of superior economic performance.
- ✓ Developing and keeping good relationships with the suppliers, besides developing potential suppliers.
- ✓ Emitting and controlling purchasing solicitation.

Purchasing records:

Purchasing records are concerned with the storage of information. This information can be filled manually or through computer system. Computerization enables vast amounts of information to be stored, obviates duplication and ensures efficient retrieval of data. A part from files of requisitions, purchase orders and other original documents, purchase records may include:

- ✓ Supplier index providing details of address, telephone, supplier's items etc.
- ✓ Supplier rating; details of supplier performance relating to price, quality, delivery etc.
- ✓ Supplier visits records
- ✓ Supplier database list
- ✓ Supplier conference records
- ✓ price trends of crucial items

- ✓ Records of materials issued to sub-contractors etc.

The period for which records providing evidence should be kept depends on the type of the contract i.e. Simple contracts may warrant the records be barred after six years from the date when the action accrued. Complex contracts may take up to twelve years from the date when the action accrued.

Purchasing Best Practices

The purchasing processes should be guided by the following practices

- Establishing well-defined requirements is essential for effective procurement. Detailed specifications ensure that all potential vendors understand the scope of work, reducing ambiguities and promoting accurate bids. This involves engaging stakeholders to gather comprehensive needs and creating precise, unambiguous documentation.
- Implementing a competitive bidding process helps in obtaining the best value for money. This practice involves inviting multiple vendors to submit proposals, which encourages competitive pricing and innovation. Ensuring that the bidding process is open and fair fosters trust and minimizes the risk of favoritism.
- Clearly defined evaluation criteria should be used to assess bids objectively. Transparency in the evaluation process prevents biases and ensures that the selection is based on merit. It is crucial to communicate these criteria to all bidders upfront to maintain fairness.
- Building strong relationships with vendors through effective management practices can lead to improved performance and reliability. This involves regular communication, performance reviews, and feedback mechanisms to address any issues promptly and maintain high standards.
- Conducting regular audits and reviews of procurement processes helps in identifying and rectifying inefficiencies or compliance issues. This practice supports accountability and continuous improvement by ensuring adherence to policies and identifying areas for enhancement.
- Upholding high ethical standards is fundamental to a trustworthy procurement process. This includes implementing codes of conduct to prevent conflicts of interest and

corruption, and establishing procedures for reporting unethical behavior. Ensuring integrity in procurement practices fosters confidence among stakeholders.

Lecture summary

In conclusion, purchasing involves obtaining goods or services through various methods, including purchasing, leasing, or borrowing. The purchasing process includes coordinating with departments, identifying suppliers, negotiating, and managing contracts. Key purchasing activities focus on ensuring the right goods are bought at the right place, time, price, quality, and quantity, known as the six R's. Objectives of the purchasing department include maintaining supply continuity of goods and services, quality, and avoiding waste. The process is divided into identification, ordering, and post-ordering phases. Finally, the proactive procurement emphasizes on long-term supplier relationships and efficient cost management.

Revision Question

1. What are the six R's of purchasing, and why are they important in the purchasing process?
2. Describe the three main phases of purchasing procedures. What key activities occur in each phase?
3. List and explain at least three objectives of the purchasing department. How do these objectives contribute to the overall effectiveness of the purchasing function?
4. What are some buying strategies used for handling small orders, emergency orders, and bulk purchases? Provide a brief description of at least three strategies.
5. Explain the concept of proactive procurement. How does it differ from reactive procurement, and what are some key elements involved in proactive procurement procedures?

References

- Purchasing and supply management; Lyson, K. Farrington, B. 7Th Edition, Pearson Education Limited, Harlow, (2007) page 1.