

# PRINCIPLES OF PURCHASING

## WEEK 3:

### TOPIC: SOURCING AND SUPPLIER SELECTION

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#### **Lecture Learning outcomes**

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

1. *Understand the supplier survey process*
2. *Understand the supplier assessment and evaluation methods*
3. *Describe the sourcing process and policies*

#### **Introduction**

A good supplier is an invaluable resource to the organisation requiring its product or service. Such suppliers make a direct contribution to a firm's success. They can assist their customers with product development, value analysis, and timely delivery of the desired level of quality. Good buyer-seller relationship facilitates the buyer's efforts to gain superior performance, extra service, cooperation on cost reduction programs, and a willingness to share in new processes and procedure, according to D. Dobler and D. Burt (2002)

#### **Supplier Survey**

Supplier survey is a comprehensive process based on identifying the available prospective suppliers in the market. Sources of information relating to potential suppliers encompass:

- **Catalogue:** This is a booklet containing details of items for sale by the supplier. They contain valuable technical information and format of presentation is simple.
- **Trade directories:** These contain new product requirements, special/occasional requirements and emergency items.
- **Yellow pages:** Entail a classified telephone directory, often printed on yellow paper that lists subscribers by the business or service provided.
- **Sales persons:** They can provide useful service information regarding suppliers
- **Exhibition:** This is a public display of products/services and it offers a great opportunity to talk with a number of potential suppliers in the same place at the same time.
- **Trade Journals:** This is a periodical containing new developments, discussions etc concerning a trade or profession.

- **Business advisers:** Local business-support organisations, such as chambers of commerce or Enterprise Agencies often point out prospective suppliers to deal with.
- **Professional peers:** This entail informal exchange of information between buyers
- **Internet**

### **Supplier assessment methods:**

Supplier appraisal may arise when a prospective vendor applies to be placed on the buyer's approved list or in the course of negotiation when the buyer wishes to assure him/herself that a supplier can meet requirements reliably.

## **SUPPLIER ASSESSMENT METHODS**

There are two main approaches used in selecting suppliers:

- Supplier appraisal – used to select potential / new suppliers
- Vendor rating – used to assess already performing suppliers.

### ***Supplier appraisal***

This is the assessment of the potential suppliers so as to be used as one of the company's suppliers. Thus, the concern is with the selection of the next suppliers. The main techniques used in supplier appraisal are:

#### ***I. Desk research:***

This is where an analysis of the supplier's document is done. The documents include:

Balance sheet, profit and loss account, organization chart etc. This analysis is done by use of statistical tools and ratio analysis. This enables the buyer to make an informed judgment on the potential of the supplier to be.

#### ***II. Field research / Capacity survey:***

*This looks into the following*

- Effectiveness of production systems.
- Quality assurance systems
- Cost control systems
- Appropriateness of the equipment's
- Attitudes and stability of management.
- Competence of technical staff
- Morale of workforce which indicates quality of service expected.
- Employee relations – in accordance of strikes, communication between managers and subordinates, past major customers and reputation of the organization
- How the company handles environmental and human rights issues.

Once the new suppliers have been selected, constant monitoring and feedback is required to either improve their performance or eliminate the non-performing ones.

### ***Vendor Rating***

It is the assessment of already performing suppliers so as to improve their performance or replace them. The two techniques used in vendor rating are:

- Subjective supplier rating method.
- Objective supplier rating method.

#### ***Subjective supplier rating method:***

A purchasing officer is appointed to observe on how well or badly the suppliers are performing and then judge each supplier. It is subjective because different individuals have different value judgments.

#### ***Advantages:***

1. It is cheap to carry out as only one observer is used and there are no records kept.
2. Is a good method to eliminate obvious shortcomings.

#### ***Disadvantages***

1. Not factual therefore personal likes and dislikes may be used by the observer.
2. Not accurate
3. It is susceptible to bribery thus the company may receive low quality items
4. No records are kept in case they may be needed for future reference.

#### ***Objective supplier rating method:***

Marks are allotted to each of the factors that determine a good supplier each time a supplier performs. These factors include: Right price, right time, right quality, right quantity, service given to the buyer, cost reduction effort, management capability.

The marks are compiled at the end of a given period and used to come up with a conclusion in respect to each supplier.

#### ***Advantages:***

1. The method is more accurate than subjective.
2. Avoids complaints / disputes as it is based on facts
3. Minimizes incidences of bribery
4. Ensures high quality goods are delivered.
5. Reference in form of records is kept in case the procurement / purchasing officer leaves office.

#### ***Disadvantages:***

1. Record keeping can be expensive.
2. The method is time consuming.

### **What should be appraised in a supplier?**

What to appraise is related to the requirements of the particular purchaser. All appraisal should however, evaluate potential suppliers from the following perspectives:

- **Finance:** The supplier should be financially stable to meet the holistic buyer's requirements.
- **Production capacity:** This entail the limiting capability of a productive unit to produce within a stated time period, normally expressed in terms of output units per unit of time.
- **Human resources:** This involves checking information regarding the title, qualification and experience of managerial staff, training schemes, encouragement of teamwork and empowerment of employees.
- **Quality:** The buyer should check critically to establish whether the supplier embraces some of the fundamental quality attributes e.g. Total quality management (TQM); International organisation for standardization (ISO) etc.
- **Performance:** The buyer should also check the track record of the supplier to establish the performance trend.
- **Environmental and ethical factors:** The buyer has a duty to check fully how the supplier approaches environmental and ethical issues. To this extent therefore, policies, and procedures in line with environmental/ethical considerations should be critically checked.
- **Information technology:** The buyer should check whether the prospective suppliers embrace the information technology. Some of issues in line with IT entail, checking whether the supplier has a website; finding out whether the suppliers procedures are automated etc.

### **Checklist for supplier visits:**

The following checklist indicates areas which warrant particular attention by procurement staff when making appraisal visits to potential suppliers:

- **Personal attitudes:** An observant visitor can sense the attitudes of the supplier's employees towards their work and this provides an indication of the likely quality of their output and service dependability.
- **Adequacy and care of production equipment:** This entail close observation of the equipment in a plant
- **Technological know-how of supervisory personnel:** Conversation with supervisors will indicate their technical knowledge and their ability to control and improve the operations of processes under their supervision.

- **Means of controlling quality:** Observation of the inspection methods will indicate their adequacy to ensure the specified quality of the product.
- **Housekeeping:** A plant which is orderly and clean in its general appearance indicates careful planning and control by management.
- **Competence of technical staff:** Conversation with design, research staffs indicate their knowledge of the latest materials, tools and processes relating to their products and on anticipated developments in their industry.
- **Competence of management:** All the above areas are, in essence a reflection of management and therefore indicate its quality.

### **Building long-term relationships with suppliers:**

Building relationship with suppliers is becoming an explicit part of the procurement strategy for both small and big companies.

Establishing long-term relationships with capable suppliers and working closely with them over time to achieve high levels of quality and productivity involves communicating intentions and expectations clearly, defining measures of success, obtaining regular feedback, and implementing corrective action plans to improve performance.

The distinct success factors for buyer-supplier relationship encompass:

*Attitude, commitments, trust, communication, coordination, motivation, conflict management, participation, culture change and most importantly continuous improvement.*

### **Supplier sourcing policies:**

Policies serve as general guidelines in making operating decisions that channel actions towards achievement of objectives.

The distinct policies in line with supplier sourcing entail:

1. Make or buy decision
2. Single/multiple sourcing,
3. E-sourcing,
4. Outsourcing,
5. Sub-contacting,
6. lean supply,
7. Partnership sourcing,
8. Co-destiny and co-maker ship

1. **Make-or –Buy Decision:** Make-or-buy decisions compare the cost of producing a component or providing a service internally with the cost of purchasing the component or

service from an external supplier. Many companies are focusing only on what they are good at and outsource the rest.

### **Factors favouring buy decision:**

Some of the circumstances and pressures favouring buy decision are:

- (a) Spread of financial risk between the purchaser and vendor
- (b) Ability to control quality when purchased from outside
- (c) Availability of vendor's specialist expertise, machinery and or/patents
- (d) Quantities required too small for economic production
- (e) Avoidance of costs of specialist machinery or labour
- (f) Reduction in inventory
- (g) When technologies are changing rapidly it becomes difficult for companies to keep pace with the needed infrastructure. Hence companies have to depend on external sources.

### **Factors favouring make decision:**

Some of the circumstances and pressures favouring buy decision are:

- (a) Greater purchasing power with larger orders of a particular material
- (b) Potential lead time reduction
- (c) Possibility of scrap utilization
- (d) Cost of work is known in advance
- (e) Large overhead recovery base
- (f) Ability to manage resources
- (g) Maintenance of company's secrecy

## **2. Single/multiple sourcing:**

### **a. Single sourcing:**

Single sourcing of an item means that the company adopts the practise of purchasing all its requirements for an item or service from one supplier although a number of suppliers may have the capability to supply. In sole sourcing, only one supplier supplies all the goods.

#### ***Advantages of single sourcing:***

- (a) Improved communication and understanding between supplier and buyer
- (b) Supplier is able to respond positively to the buyer's feedback on quality issues, engineering changes, design changes and suggestions that can reduce cost
- (c) Elimination of supplier 'switching' costs
- (d) Reduction in total cost of product due to bulk purchases
- (e) Reduction in supplier communication faxes, telephone calls and paperwork

- (f) Enhanced ability to implement just-in-time (JIT) procurement, since scheduling communication and planning permits more effective and efficient handling of inventory and orders
- (g) Personal relationship at various levels between buyer and supplier can be established easily, making communications more effective

***Disadvantages of single sourcing:***

- (a) If a defect in the supply is noticed after the product is produced and dispatched to the buyer's plant the cost of quality would be very high
- (b) A fire, strike or breakdown in the single source supplier's plant can stop production in the buyer's plant
- (c) Less market intelligence and reduced flexibility, being committed to lean, single/sole-source Research and development, technological capability and creativity
- (d) If the supplier is unable to share competitive pressure and reduce costs of his products concurrently the buyer will be at a competitive disadvantage
- (e) Constant pressure to improve the quality, delivery and price of a product may frustrate the supplier and make him break the relationship

**b. Multiple sourcing:**

Multiple sourcing of item(s) means that the company adopts the practise of purchasing all its requirements from various suppliers in the market. The objective of multiple sourcing is to maximise benefit on prices and services. In situations of multiple sourcing, both buyers and suppliers feel a high level of uncertainty and therefore there are multiple controls to ensure successful transaction.

***Advantages of multiple sourcing:***

- (a) It allows using various supplier's creativity, ideas, innovation and newer materials
- (b) It gives flexibility to the buyer to meet large quantities orders or sudden changes in schedules
- (c) It allows the buyer to share the risk in uncertainty or crisis
- (d) The buyer has a stronger negotiation position
- (e) Insurance against just-in-case situation like fire, strike, poor quality delivery, breakdown of machines
- (f) With many suppliers holding stock, the buyer can reduce inventory levels

***Disadvantages of multiple sourcing:***

- (a) Small order quantities sometimes decrease the supplier's morale
- (b) More communication and paper work cost
- (c) Weak buyer-supplier partnership
- (d) More waste, scrap levels, rework, maintenance, delays, down-time, warranty claims, resulting from frequent set-ups and variation in supply from multiple suppliers raise the cost of quality.

**3. E-sourcing:**

E-sourcing is a collection of collaborative, web-based tools that enable procurement professionals and suppliers to conduct the strategic activities within the procurement lifecycle over the internet. These strategic activities including requirements and specification definition, tendering and supplier selection, and contract award and management are designed to deliver value for money procurement solutions to the public sector. E-sourcing helps to encourage consistency with policy and best practice and increase sourcing and contract management efficiency and effectiveness.

#### **4. Outsourcing:**

This is a management strategy by which an organisation out sources major non-core functions to specialised, efficient service providers. The basic objective is normally cost reduction and concentration on core activities.

#### **5. Sub-contracting**

Sub-contracting relieves the main contractor of some duties and therefore being in a position to concentrate on supervision. Also sub-contracting reduces cost on the part of main contractor as well as attracting highly qualified and experienced experts to do the job.

#### **6. Lean supply**

In this policy the purchaser seeks to minimize the number of suppliers. This is done because of the following reasons: promote high standards and quality, enable development of good buyer-supplier development, promote accountability, aid the implementation of quality management systems etc. Lean supply chain management is considered by businesses who want to streamline their processes by eliminating waste and non-value added activities.

#### **7. Partnership sourcing:**

This is the commitment to both customers and suppliers, regardless of size, to a long-term relationship based on clear, mutually agreed objectives to strive for world class capability. Partnering aims to transform short-term adversarial customer/supplier relationships focussed on the use of purchasing power to secure lower prices and improved delivery into long term cooperation based on mutual trust in which quality, innovation and shared values compliment price-competitiveness.

#### **8. Co-destiny and co-maker ship:**

Co-makership and Co-destiny may be defined as close cooperation between the buyer and seller organisations in respect of product development, manufacture or supply. Also co-makership can be defined as working together so that each party benefits more from collaboration than working independently.

### **Supplier development policies:**

This is any activity that a buying firm undertakes to improve a supplier's performance and capabilities to meet the buying firm's supply needs. Supplier development is accomplished by: instigating competition among suppliers, working directly with suppliers through training and other activities, assessing supplier's operations and also providing incentives to improve performance.

Supplier development in world class firms is proactive and it focuses on helping suppliers retain the learning that occurs in the development process to help them improve their own systems. Supplier development requires that both firm commit financial, capital and personnel resources to work; share timely and sensitive information and create an effective means of measuring performance and progress.

### **Approaches of Supplier Development**

#### ***Early supplier involvement (ESI)***

ESI is an approach in supply management to bring the expertise and collaborative synergy of suppliers into the design process. ESI seeks to find "win – win" opportunities in developing alternatives and improvements to materials, services, technology, specifications and tolerances, standards, order quantities and lead time, processes, packaging, transportation, redesigns, assembly changes, design cycle time, and inventory reductions. Today, early supplier involvement (ESI) is an important accepted way of life at many proactive firms and a requirement for world class supply management.

The suppliers are carefully prequalified to ensure that they possess both the desired technology and the right management capability.

ESI is critical in reducing the cost of production, improving quality and preventing costly delays.

### **Advantages of Early Supplier Involvement**

The advantages of ESI in product development may be briefly summarized as:

- a) Improved product specification
- b) Enhanced quality
- c) Lower development costs
- d) Access to new technologies a head of competitors'
- e) Joint problem-solving
- f) Interchanging of knowledge and information
- g) Improved manufacturability of products

## **The disadvantages and problems of early supplier involvement**

The disadvantages and problems of ESI have been summarized as follows:

- a) There is fear of leakage of vital information
- b) Loss of control or ownership.
- c) There is longer development lead-time
- d) There are conflicts due to different aims and objectives
- e) Collaborators could end up being competitors.

Factors to consider or point out when developing Early supplier involvement

- Degree of responsibility for design
- When to involve the supplier in the process
- Intercompany communication
- Intellectual property agreement

## **Chapter Summary**

In this chapter, the following has been observed.

- Strong supplier relationships are vital for organizational success, enhancing product development and quality.
- Effective sourcing requires comprehensive supplier surveys and robust assessment methods for both new and existing suppliers.
- Various sourcing policies, such as make-or-buy decisions and single versus multiple sourcing, significantly impact procurement strategy.
- Supplier development and Early Supplier Involvement (ESI) foster collaboration and improve product quality.

## **Revision Questions**

1. What are the key benefits of maintaining a good buyer-seller relationship?
2. Describe the main techniques used in supplier appraisal and the areas they focus on.
3. Compare and contrast the subjective and objective supplier rating methods.
4. What factors should be considered when evaluating a potential supplier's performance?

5. Explain the concept of Early Supplier Involvement (ESI) and its advantages.

### **Reference**

Purchasing and supply management; D. Dobler and D. Burt. 6<sup>th</sup> Edition, McGraw-Hill Companies. New York (2002) page 211