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Chapter 3: Purchasing Fundamentals

Objectives

- Understand what purchasing is.
- Examine the 7Rs of purchasing.
- Examine the role of Purchasing Dept in the execution of the purchasing cycle.

1. Introduction

As mentioned in Chapter 1, logistics comprises material management and physical distribution. Purchasing is one of the main functions of logistics in the acquisition of materials and services for the organization.

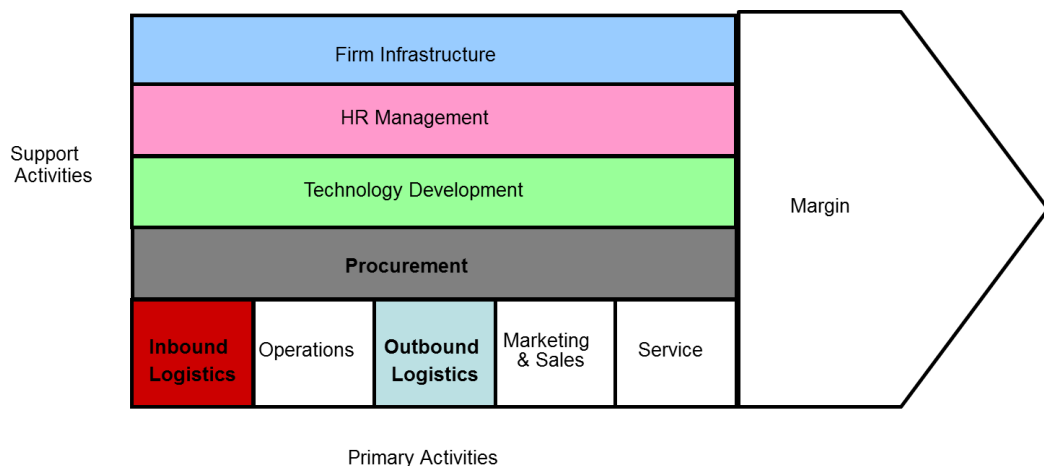


Figure 3-1: Value Chain

In any value chain, there are two groups of activities:

- Primary activities.
- Support activities.

Procurement is one of the main support activities. It plays a significant contribution of margin as shown in Figure 3-1.

2. Definition of Purchasing

The purchasing responsibility is sometimes defined as buying materials of the right quality, in the right quantity, at the right time, at the right price, from the right source. This is a broad generalization, indicating the scope of the purchasing function that involves policy decisions and analyses of various alternative possibilities prior to the act of purchase. The significance of the definition depends, of course, on the

interpretation of what is "right" and requires the consideration of many factors. At this juncture, let us define what purchasing is.

Purchasing is defined as “purchasing materials and items of the right specifications and quality, at the right time, in the right quantity, from the right source and at the right price”.

Wild, 1995, p488

3. Objectives of Purchasing

The objectives of purchasing are to ensure that an organization has the:

- Right material
- Right quantity
- Right quality
- Right time
- Right place
- Right price
- Right supplier

These are termed the 7 Rs' of purchasing and supply and we shall seek now to analyze and interpret the term 'right' material.

What is 'the right material'? First and foremost it is that material required for the production plan; or, in other words, what is needed to meet the sales forecast within a production industry or, in the case of a distributive industry, to meet the demand of the market.

Secondly, the right material is that material which is specified correctly. It is very important, when purchase orders or contracts are being signed and issued from the purchasing that great care is taken to ensure that the items detailed on the order are correctly specified, that any drawings which are associated with the order are quite specifically referred to.

Wherever possible, a universally accepted standard is quoted. All too often, we find that materials are rejected on receipt, and the cause of this rejection can be traced back to the fact that a proper specification of what was actually required had not been stated.

The necessity to be precise about specifications has a legal connotation in purchasing, because a situation could arise where a supplier places his own interpretation on the requirement in an order or contract which did not contain a quoted specification or drawing number. If the materials were found to be

unacceptable by the buyer, the fact that no specification was quoted and the supplier had interpreted the order to the best of his ability might be upheld in a court of law, and the buyer could find himself having to pay for something which was of no use to the company.

Thirdly, the right material is material which fulfills a current need. Stocking costs today are so high that purchasing has to satisfy itself before placing any orders or contracts that the goods will be able to be put into use within a reasonable time after receipt.

Purchasing should make people aware of stocking costs within the organization before the commitment of purchase is entered into.

A more specific statement of the overall objectives of purchasing would include the following the following:

- Provide an uninterrupted flow of materials, supplies, and services required to operate the organization.
- Keep inventory investment and loss at a minimum. One way to ensure an uninterrupted material flow is to keep large inventory.
- Maintain and improve quality. To produce the desired product or service, a certain quality level is required for each material input.
- Find or develop competent suppliers. The success of the purchasing department depends on its skill in locating or developing suppliers, analyzing supplier capabilities, selecting the appropriate supplier, and then working with that supplier to obtain continuous process improvement.
- Purchase required items and services at lowest total cost.
- Improve the organization's competitive position. An organization will be competitive only if it can control all supply chain costs and times in order to avoid non-value and time-adding activities like extra storages, transportations, and inspections.

In the long run, the success of any organization is dependent on its ability to create and maintain a customer, and the effective and efficient management of supply directly and indirectly impacts the end customer.

4. The Basic Purchasing Process

A user department indicates its need for materials on a requisition. It uses a materials requisition to obtain materials that are in regular use in the plant and that are carried as normal stock. This may go directly to warehouse and the requirements are supplied from there.

A purchase requisition is used for materials that have to be ordered from suppliers. The person who needs the material fills in either type of form with the material name or code identification, the amount needed, and the desired delivery date.

In many computerized operations, computer-generated schedules are EDI to the supplier without a purchase requisition being generated. In these cases, purchasing will have already negotiated price and terms, usually for one year or longer.

The essential steps in purchasing process are:

- Recognition of need
- Description of the need
- Selection of sources
- Determine price and terms
- Preparation and placement of the purchase order
- Follow up and/or expedite the order
- Receipt and inspection of goods
- Invoice clearance

5. Recognition of Need

Any purchase originates with the recognition of a definite need by someone in the organization. The person responsible for a particular activity should know what the individual requirements of the unit are - what, how much, and when it is needed.

Some purchase requisitions originate within the production or using department. Requests for office equipment of all sorts might come from the office manager or from the controller of the company.

Some requests come from the sales or advertising departments or from research laboratories.

6. Accurate Description of Desired Commodity or Service

No purchaser can be expected to buy without knowing exactly what the using departments want. For this reason, it is essential to have an accurate description of the need, the article, the commodity, or the service which is requested.

Purchasing and the user, or the cross-functional sourcing team, share responsibility for accurately describing the item or service needed.

The purchaser should question a specification if it appears that the organization might be served better through a modification.

7. Selection of Possible Sources of Supply

Supplier selection constitutes an important part of the purchasing function, and involves the location of qualified sources of supply and assessing the probability that a purchase agreement would result in on-time delivery of satisfactory product and needed services before and after the sale.

Among the basic records, computerized or hard copy, in a well-organized supply office should be:

- Outstanding contracts against which orders are placed as required.
- A commodity classification of items purchased.
- A record of suppliers.

8. Determination of price and Terms

Analysis of the quotes and the selection of the supplier lead to the placing of an order. Since analysis of bids and the selection of the supplier are matters of judgment, it is necessary only to indicate here that they are logical steps in purchasing. And many purchases are placed through other than bidding, for example, from price lists or through negotiation.

9. Preparation of the Purchase Order

The processes of negotiation and decision take place between the time at which a purchase is authorized and the time at which the order is issued. It is part of purchasing system to send the invitation to suppliers to bid and to evaluate the bids received.

10. Follow-Up and Expediting

After a PO has been issued to a supplier, the buyer may wish to follow up and/or expedite the order. At the time the order is issued, an appropriate follow-up date is indicated. In some firms, purchasing has full-time follow-up and expediting personnel.

Follow-up is the routine tracking of an order to ensure that the supplier will be able to meet delivery promises. If problems - for example, quality or delivery - are developing, the buyer needs to know this as soon as possible, so that appropriate action can be taken.

11. Receipt and Inspection of Goods

The function of the warehousing is to:

- Receive in-coming goods.
- Sign the delivery notice presented by the carrier or the supplier in connection with the shipment.
- Identify and record all income materials.
- Report their receipt to the purchasing department.
- Make prompt disposition of the goods to the appropriate department.

The warehousing notifies the department responsible for inspection that the shipment has arrived and takes whatever samples may be necessary or otherwise makes the material available for inspection.

12. Clearing the Invoice and Payment

The invoice constitutes a claim against the buyer and needs to be handled with care. Invoices commonly are requested in duplicate. Often invoices must show order number and itemized price for each article invoiced.

Procedure relating to invoice clearance is not uniform. In fact, there is a difference of opinion on whether the checking and approval of the invoice is a function of the supply department or of the accounting department. Clearly, the invoice must be checked and audited.

13. Conclusion

This chapter reviews what purchasing is and its significant role in logistics. The purchase of materials or services follows a systematic process beginning with understand user's need and ending with the purchase of the materials or services for the organization.

Reference

1. Porter, M E (1985) Competitive Advantage: Creating and Sustaining Superior Performance, New York, Simon & Schuster.
2. Wild, C.R (1995) Production and Operations Management, 5th Edition, Cassell.