

Purchasing and procurement



In history, the term purchasing appeared in half late nineteenth century, when the Industrial Revolution was at the peak point of development. At that time, purchasing function was just selecting, buying, receiving and delivering all commodities required. Gradually, the function of purchasing has developed more but not much until the late of twenty century when the globalization was booming and information technology had reached some breakthrough achievements. That was the time when companies began broadening their businesses into global. Since the demand of not only raw materials but also outsource services was increasing, the role of purchasing moved up to a new level. Purchasing was no more in the passive state but evolved to active state. Purchasing nowadays plays an important role to support the corporation to achieve the competitive advantage. Therefore the term “ procurement” comes to light. The following sections will discuss more specifically about the purchasing and the procurement.

2. PURCHASING

2. 1. THE DEFINITION OF PURCHASING

For anyone of us, term “ purchasing” is very familiar. In daily life, we just understand this word with mean “ buy”. However, in business, purchasing is defined as a functional group that performs many activities to ensure it delivers maximum value to the organization. These activities include supplier identification and selection, buying, negotiation and contracting, supply market research, supplier measurement and improvement, and purchasing systems development.

2. 2. THE OBJECTIVES OF PURCHASING

The objectives of purchasing are quite simple. Purchasing must buy materials of the right quality, in the right quantity from the right source delivered to the right place at the right time at the right price. At first, the objectives sound reasonable but there is something not practical. The word “right” is a vague concept because there is nothing to measure how right each objective should be. Furthermore, in reality, some objectives can conflict with each other. For instance, it is hard to find the right quality with right price because the best suppliers usually come along with high price.

According to Lysons and Farrington (2006, p6), above definition has three points that need to pay attention:

Reactive rather than proactive – this means that purchasing just try to fulfill the orders but not contribute to the company’s competency.

Transactional rather than relational – this means that purchasing only concern with the price that suppliers offer but not try to build the long-term partnership to support each other.

Tactical rather than strategic – this means that purchasing only focus to complete the mission in short term but not planning the strategy for the long term.

2. 3. THE PROCESS OF PURCHASING

As Ameredes (2007, p1) mentioned, the traditional purchasing process is split into 9 steps:

Research products – checking the catalogs, acquiring a phone, letter head or web quote

Create requisition – a requisition is composed to purchase goods from a supplier.

Requisition approval – depending on the budget set by the organization, the requisition is routed to an approver who has the option to reject, change account numbers, quantities, etc.

Purchase order – the purchase order is created after the approval

Supplier creates sale order and fills – POs are registered into the supplier's sales order system. Then, if the goods are in stock, the supplier will pick items for shipment, produce a packing slip and then ship the items.

Receipt of goods – organizational audit controls will define whether receipts need to occur centrally or at the desktop. Centrally means that your organization has a central receiving dock where deliveries and records of receipted goods are systematically tracked.

Supplier invoice received – the supplier invoice is received either on paper

Pay supplier – all invoices that have had all invoice lines successfully matched are approved for payment then the payment is executed.

Post expense to GL – the transaction's life cycle expires as an expense in the General Ledger.

Research products for purchase

Create requisition

Requisition approval

Purchase order

Receipt of goods; receipt is entered against PO

Supplier creates sale order & fills (generate packing slip and invoice)

Pay supplier

Supplier invoice received

Post expense to GL

Traditional Purchasing Process (Ameredes. 2007, p1)

Even though the process of traditional purchasing looks simple, it contains a lot of issues. Without the support of the information technology, there are a lot of non – value – adding clerical activities. Normally, for a new buy purchase, a minimum of seven different documents (requisition, enquiry, quotation, order acknowledgement, advice note, goods received note and invoice) are needed to be signed. Moreover, waste times are taken to process orders, both internally and externally. And the cost is paid very high for non – add – value activity like pure transaction.

3. PROCUREMENT

3. 1. THE DEFINITION OF PROCUREMENT

According to many authors, procurement can be define in many ways but still has some basic points. Lysons (2006, p6) defined that procurement is a

wider term than purchasing and obtaining good or services in any way, including borrow, leasing or even force or pillage.

In the definition of Dobler (1997, p37), procurement does not only include the function of purchasing but also attach others activity such as material specifications, material studies and value analysis, management of supplier quality, purchase of inbound transportation, management of investment recovery.

However, in their text, Handfield, et al (2011, pp10 – 12) consider purchasing and procurement are the same while defining supply management more broaden, “ supply management is strategic approach to planning for and acquiring the organization’s current and future needs through effectively managing the supply base, utilizing a process orientation in conjunction with cross – functional teams to achieve the organizational mission.” Although giving the specific definitions, they did not distinguish the usage of three terms purchasing, procurement and supply management clearly.

Besides, Kaufmann (1995, p277) prefers sourcing as a higher level of purchasing, “ an integrative management approach to designing all supplier relations in the sense of a total relationship management”

Not only Handfield, et al (2011, p12) and Dobler (1997, p37) use supply management as the wider concept of purchasing but also Arnold (1997, p6) use it to describe the broaden figures of purchasing including materials management, inbound logistics, and outbound logistics.

In contrast with above opinions, Tempelmeir (1995, p3) explains the term procurement as all activities aiming at supplying the company with needed inputs

Although having the same definition of procurement with Tempelmeir, Corsten (1994B, p191) shows that supply management is the procurement with a strategic focus that acts proactively and contributes significantly to company performance.

Despite of different ways to define procurement term, there are some common ideas. Definitely purchasing is the basic level of the way of obtaining the material. Then procurement is the next level of purchasing. Not only acquiring the materials and services but procurement also involves in supporting the organization to achieve competitive advantage.

3. 2. THE OBJECTIVES OF PROCUREMENT

Under tree drivers, globalization, information technology, changing production and management methods, the philosophies of purchasing rapidly have changed recently. According to Handfield (2011, p2011, pp42 – 44) procurement's objective are no longer is to obtain goods and services in response to internal needs but include five new primary ones.

The first objective is keeping the supply flow continuously. This means the traditional role of purchasing function still maintained in the procurement. In other words, procurement must fulfill the needs of operations through purchase the services, raw materials, components, subassemblies, and repair and maintenance items. Moreover, procurement may support the requirements of physical distribution centers responsible for storing and

delivering replacement parts or finished products to end customers. Besides, procurement supports engineering and technical groups (such as IT), particularly during new – product/ service development and outsourcing of key processes.

The second objective is managing the sourcing process efficiently and effectively. In order to achieve this objective, procurement must do as followings:

Determining staffing levels

Developing and adhering to administrative budgets

Providing professional training and growth opportunities for employees

Introducing improved buying channels within the procure to pay systems that lead to improved spending visibility, efficient invoicing and payment, and user satisfaction

The third objective is developing supply base management. This means procurement must do the selection, development, and maintenance of suppliers. More specifically, procurement has to:

Choosing competitive suppliers

Identify new suppliers with potential for excellent performance and developing tight relationships with these suppliers

Improving existing suppliers

Developing new suppliers that are not competitive with current suppliers

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With this objective, procurement now gets closer to the supplier and works with more cooperation than pure transaction. This point is totally different from the purchasing because procurement is no longer deal with internal organization's tasks but also the external ones. By doing this procurement can gain a supply base capable of providing performance advantages in product cost, quality, technology, delivery, and new – product development.

The fourth objective is developing aligned goals with internal stakeholders. In the past, each cross – function was like an isle which was no connection with others. However this ways does not work on temporary business. There is a need to do the cross – functional interaction and cross – boundary communication. Therefore, procurement must make connection with other functions which have an important stake in the effectiveness of purchasing performance.

The last objective is developing integrated purchasing strategies that support organizational goals and objectives. This means the procurement can directly affect (positively or negatively) the long – term growth, revenue, and operating outcomes and plans of internal customers. If procurement can actively take part in the corporate planning process, it will give the supply market intelligence that contributes to strategic planning. Supply market intelligence can be:

Monitoring supply markets and trends(for examples, material price increases, shortages, changes in suppliers) and interpreting the impact of these trends on company strategies

Identifying the critical materials and services required to support company strategies in key performance areas, particularly during new – product development

Developing supply options and contingency plans that support company plans

Supporting the organization’s need for a diverse and globally competitive supply base

3. 3. THE PROCESS OF PROCUREMENT

Because the procurement now plays an important role in the strategic planning of organization, it takes more responsibilities. According to Handfield, et al (2011, p45 – 50) the strategic procurement process is showed as below:

Procurement Strategy

Spend Analysis/ Management

Demand Management & Specs/SOW’s

Category Strategy & Supplier Evaluation

Cost Management

Rate and UNIT of consumption is used as an input to manage demand, which is used as an input into category strategy

Procure – to – Pay Process

Supplier Relationship Management

Contract Management

Strategic Procurement Processes (Handfield, et al, 2011, p 50)

Spend analysis is the process of collecting historical data by commodity, relative to demand from the lines of business, with the exception of personnel expenses, occupancy, and corporate spend. The result is used to coordinate demand management, commodity management, and risk management strategies. It is helpful to communicate with business partners to know where they spent their money and why it was spent.

Demand management is the process of using UNIT and RATE consumption to levels to forecast and estimate future consumption in an internal function customer, and providing guidance and input on how to optimize usage and educating the user on the tradeoffs. Demand management activities may involve:

Optimization of sourcing strategies based on how much the team projects they will buy

Proactively setting policies, procedures, and measurement systems that throttle the consumption and total expenditures of a unit of category of spend

Ensuring appropriate levels of capacity in the supply base required to minimize risk.

Establishing a fixed set of standards to limit options, and restricting the supply base to include only preferred suppliers who comply with risk and compliance requirements.

Specifications/SOW's is the process that procurement combines the knowledge and expertise about a wide variety of materials and services with the organization's benefit.

Category management is the process of developing external industry intelligence and analysis, internal demand, supply base capabilities and operational risks, and a strategy to approach that marketplace with our needs to match it with what suppliers can offer.

Contract management is a process associated with defining the contract, defining roles and responsibilities of both parties, and advising when to modify and ensure appropriate escalation.

Cost management is the process of analysis the price paid and other components of price over the life cycle of a product or service, to deliver a target cost and a unit rate to determine if it is priced competitively in the marketplace. Cost management can help to make decision in many cases:

The cost of supporting a process or commodity

The gap between cost drivers and the assumed business case

Identifying the business case

The total cost of offering a service, including all of the elements of receiving, use, and disposal over the life cycle of the offering.

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Managing the procure to pay process concerns with the automation of all transactional activities associated with the thread of events that occurs from the time of buying a good or service, through the release mechanism, to the point of issuing payment, including: requisitioning, RFX, contract award, orders, approval, receipt, payment

Supplier Relationship Management is the end – to – end process of managing a supplier through the entire sourcing life cycle, which includes first identifying the abilities of a particular company with regard to performing a service for the internal customer, completing a sourcing event, negotiating a contract, executing an order, and determining payment. All aspect of the relationship can include:

Day – to – day transactions

Identification and mitigation of operational risk and deliverables

Business continuity planning

Understanding the suppliers' business challenges

Identification of opportunities to improve value and reduce cost

Establishing scorecard metrics for improvement and reviewing progress towards these objectives

Contract terms and conditions

Leveraging the flow of information between key internal process owners and the supplier to create value

A procurement strategy is a holistic plan for designing the organization, assigning resources, and aligning these resources against the demands placed on the supply chain by the business. A well – developed procurement strategy includes:

A repeatable and well – defined process for building strategy and governance around defining, planning, managing, and receiving products and services for a business

Clear alignment with executive vision and internal user – specific business goals

A process based on well – developed supplier market intelligence and input from executives and internal customers

Established goals and metrics for short – term project plans, as well as a define five – year plan

Established communication plan to inform senior management and all lines of business updated and reviewed quarterly against defined goals and objectives

4. CONCLUSION

In summary, the different point between the purchasing and the procurement is range of affection to the business plan of an organization.

While purchasing has the tactical trend, procurement involves more in strategic focus. Purchasing just focuses on acquiring the goods and services with best quality and price, while procurement span the affection through the supply chain. Purchasing does not care about the suppliers but

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procurement considers the important of relationships. Finally, purchasing is always in the passive state and follows the influence of incoming events while procurement can plan a head the future.