


# PURCHASING MANAGEMENT

The background features a gradient from dark blue on the left to light blue on the right. In the lower half, there are several overlapping, wavy horizontal bands in shades of blue, yellow, and white, creating a sense of movement and depth.

# OVERVIEW

- Introduction
  - importance of purchase Department
  - functions of purchase Department
  - Organization for purchase function
  - centralized and decentralized purchasing
  - objectives of purchasing
  - i.e. 6R's of purchasing.
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# Introduction

- Purchasing management is a department in an organization responsible for purchasing activities. Purchase is Most Important Function in any Organization.
- Purchase is the first element which affects the product cost. Purchase management decides profitability of the Company.
- The purchasing management department ensures that all goods, supplies and inventory needed to operate the business are ordered and kept in stock.
- It is also responsible for controlling the cost of the goods ordered, controlling inventory levels and building strong relationships with suppliers

# Objective

- To keep department expenses low.
- Development of good & new vendors (suppliers).
- Development of good relation with the existing suppliers.
- Training & development of personal employees in department.
- To maintain proper & up to date records of all transactions.
- Participating in development of new material and products.
- To contribute in product improvement.
- To avoid Stock- out situations.
- To develop policies & procedure.

# Functions of Purchasing Management

## 1. Receive Purchase Request

- Starting point of procurement activity.
- It is the Statement of Requirement of Production.

## 2. Review and evaluate Requisitions

Purchase Department reviews the following:-

- Item description
- Quantity
- Estimated purchase price or last purchased price
- Consumption pattern in the last 3 years
- When the material is required



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Templates

Date	Deliver To
Requisition #	
Requested By	Recommended Suppliers
Approved By	
Charge To Account	

[illegible]

## CITY OF \_\_\_\_\_, TENNESSEE

### Requisition for Supplies

Req. No. (department file number)

**To be purchased from:**

(This area to be filled in by purchasing department unless there is only one supplier for items requested.)

To be delivered to:

Give specific delivery instructions, including name of person designated to receive the item(s), department and street address.

Department Head (signature of department head)

Department Head (signature of department head)

*Suggested vendors:*

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_

[illegible]

Competitive Prices: (To be filled in by purchasing)

Approved:

Finance Officer

Purchasing Agent

### 3. Supplier selection

- Deciding on the mode of procurement
- Invitation to tender is issued

### 4. Scrutiny of Offers

- Reply of a supplier to the invitation to tender is called an Offer.
- An offer is scrutinized for its specifications, price and other terms and conditions.

### 5. Order placement

- Purchasing Department selects
- the supplier & places order.

## 7. Market research and Information

- Discussions & meetings between supplier representatives
- Keeps in check, the latest developments with respect to the company and its product .
- Studies new developments in production materials & processes.

## 8. Payment Authorization

- Ensuring all goods are delivered before payment is made.



# PURCHASING CYCLE

- Recognition of need
- Description of need
- selection of suitable source
- Price and availability are determined
- Purchase order is prepared and sent out to the supplier
- Acceptance of the purchase order is obtained
- Follow up is done by the purchasing department
- Checking the invoice and approving it for making payment

# Recognition of need

- 1 Insurance of requisitions
- 2. Insurance of Bill materials

# Description of need

- The purchase requisition described the required item.
- In order to assure complete and accurate information for ordering, the requisition must include all necessary information.

# selection of suitable source

- A right supplier is one who delivers materials of the correct specifications on the specific delivery dates
- Single supplier helps develop long-term relationship and reduce the risk and interruption in the supply.
- Multiple suppliers may not help in maintaining quality and helps get material at competitive prices.

# Price and availability are determined

## Methods :

1. Vendor's catalogues and price list are available for standard items
2. Negotiation : bargaining between buyer and seller
3. Inviting tenders or quotations

Purchase order is prepared and sent out to the supplier

### Purchase order

The legal order is placed with the supplier on a form is known as purchase order

# Order acknowledgement

Order acknowledgement is to get a definite commitment from the supplier about the supply of items on time.

# Follow up

- Follow up is done to ensure that the items ordered are delivered by the supplier on time.
- Though a general policy should be established for the entire purchasing department, the immediate responsibility for expediting is likely to rest on the buyer who placed the order



- Checking the voice and approving it for making payment

# Selection of Vendors

- This is the process where the organization identifies potential suppliers for specified supplies, services or equipment.
- These suppliers' credentials and history are analyzed, with the products or services they offer.
- purchasing managers research potential bidders obtaining information on the organizations and products from media sources and their own industry contacts.
- This selection process can include or exclude international suppliers depending on organizational goals and criteria.

# Negotiating

- Negotiating is a key skill set in the Purchasing field. One of the goals of Purchasing Agents is to acquire goods per the most advantageous terms of the buying entity.
- Purchasing Agents typically attempt to decrease costs while meeting the Buyer's other requirements such as an on-time delivery, compliance to the commercial terms and conditions.
- That savings could exceed the annual budget of the department, which in effect would pay the department's overhead - the employee's salaries, computers, office space, etc.

# VALUE ANALYSIS

- Also called as 'Value Engineering'
- It is a combination of Purchasing and Methods Engineering.
- This activity is aimed at modifying the specification of materials, parts & products to reduce their cost.
- Value analysis has wide acceptance as it offers increased value of a product without increasing the cost and it reduces the cost without reducing the usefulness of the product.
- It is widely used by many companies and governmental agencies.

- A value analysis team or committee takes a product, which has been designed or produced.
- Then they attempt to define what function, product should fulfill.
- the analysis committee tries to perform that function at the lowest possible cost.


### **Comparative Analysis**

- Value analysis may investigate all identical parts purchased by the company and this investigation can expose opportunities to cut costs of some of these parts.

### **Supplier contacts**

- Supplier contacts is yet another approach to value analysis. Smart purchasing personnel maintain close contact with suppliers who suggest improvement and cost- reduction ideas.

# METHODS OF PURCHASING

- Purchasing according to requirements.
  - Purchasing for some definite future period.
  - Market Purchasing.
  - Speculative Purchasing.
  - Contract Purchasing.
  - Scheduled Purchasing.
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- A decorative graphic on the right side of the slide, consisting of several overlapping, curved, wavy shapes in shades of light blue, yellow, and a darker blue, creating a modern, abstract design.

# PURCHASING ACCORDING TO THE REQUIREMENTS

This method is appropriate for those items which are not of regular and common use in the production process. These items are generally not stored in inventories. And Purchasing department should keep a record of reliable and trustworthy suppliers who were sincere to the organisation in past .

# PURCHASING FOR SOME DEFINITE FUTURE PERIOD

This method of purchasing is generally used for those items, which are regularly consumed, but the consumption is comparatively low and the price changes for these items are not much.



# MARKET PURCHASING

- Purchase of goods usually in smaller quantities or in an emergency without contract or negotiations .

# SPECULATIVE PURCHASING

- When purchasing is done purely from the point of view of taking advantage of a speculated rise in price of the commodity.
- The intent is not to buy for the internal consumption but to resell the commodity at a later date when the prices have gone up & to make a profit by selling.
- The items may be those that are needed for internal consumption but the qty. shall be much more than the requirement so as to take the advantage of the coming price rise.

# CONTRACT PURCHASING

- In this, the purchase department enters into agreement with various suppliers to supply the items at some future period periodically.
- In contract purchasing, a purchaser agrees to buy goods to be paid for in a series of installments, each comprising a proportion of the capital and an interest element.
- After a final payment, legal ownership passes to the user.

# SCHEDULED PURCHASING

The purchasing is scheduled according to the requirements of the various departments or of the organisation.

# centralized and decentralized purchasing

- **Centralized Purchase Management**

Centralized procurement means that a single department controls and manages the purchasing for the whole organisation. Ideally a manager oversees the purchasing department regarding what materials need to be purchased and in what quantity. The single purchasing department is generally located in the headquarters.

# Decentralized Purchase Management

- With this method, rather than leaving the purchasing control with a single department, it is granted to local branches or departments. They have the authority to purchase items necessary as per their requirements.

# Centralized Purchasing – Pros

1. Purchasing in bulk quantities reduces cost to the organization.
2. Good relations developed with the supplier can lead to better discounts and bargain in the future.
3. Since shipments are consolidated, the transport cost is also reduced.
4. Inventory investment can be minimized through centralization of purchase.
5. Inventory management gets drastically reduced.
6. Duplication of work can be avoided through centralized purchasing.
7. Policies formulated for purchasing can be maintained uniformly through centralized purchasing.
8. Centralized records can be maintained.
9. Since a single department is involved, the quality of the materials can also be maintained.
10. A centralized store can be maintained under centralized purchasing.

# Centralized Purchasing – Cons

1. High initial cost can be a deterrent.
2. People in charge of purchasing may not be efficient and this can lead to poor quality of materials purchased and even incorrect quantity being purchased.
3. If branches are spread out geographically, then centralized purchasing may not be suitable.
4. In case of an emergency, work can be delayed drastically since materials cannot be purchased locally.
5. Delay in replacement of defective materials.
6. If the wrong amount of material is purchased, it will be a loss to the organization.



# 6R's of purchasing

1. Right Quality
2. Right Quantity
3. Right Time
4. Right Source
5. Right Price and
6. Right Place.

# Right Quality

- The term right quality refers to a suitability of an item for the purpose it is required. For producing the goods of best quality, the best grade of raw material may be the right quality whereas for producing items of medium quality, the average lowest grade may be the right quality.
- The quality of the item is called as grades. It can be measured by physical tests, chemical analysis or by any other methods depending upon the nature of a product. The use of standard specification, brand name or trade name helps in purchasing the required qualities of materials. 'The quality must be built into the product'. It is the duty of the purchasing department to ensure that materials are purchased from those suppliers.
- For creating goodwill, right production, standardisation, elimination of waste and for better results, right quality purchases are very essential. Quality for different materials is decided by the concerned departments.
- In case of workshop equipment, the decision is taken by the plant engineer and for stationery it is the user department. However, purchase department may question the requirements of the different departments on the basis of its experience and suggest various alternatives. The inspection department must verify whether the goods supplied are in accordance with the order placed.
- Thus, the right quality is the suitability of items purchased for a given purpose. The best quality of materials purchased need not be the right quality.

# Right Quantity

Materials purchased should be of right quantity. The right quantity is the quantity that may be purchased at a time with the minimum total cost and which obviates shortage of materials. Ensuring and maintaining a regular flow of materials for carrying the production activity is the vital aim of any purchase organisation. Excess purchases should be avoided, it results in overstocking and capital is unnecessarily blocked and inventory carrying cost goes up.

$$EOQ = \sqrt{AB/CS}$$

A annual consumption

B buying cost per order

C cost per unit

S storage cost

- For deducing the amount of right quantity to be purchased, certain important factors must be considered by the management. These are the nature of the manufacturing process, the nature of material to be used, prevailing market conditions i.e., changes in the tastes and preferences of the people, cost of materials to be purchased, cost of possession and storing capacity of the organisation.
- Along with the economic order quantity, there are two more concepts, viz.; bulk order quantity and arbitrary order quantity which needs to be understood.
- Bulk Order Quantity is the quantity which is larger than the economic order quantity. It combines the ordering quantity of more than one order so as to round off to 3, 6 or 12 monthly requirements and place a single order for the full requirements of a period under consideration.
- Bulk order quantity ensures various economies of price, lesser operational cost in the purchase department. Inexpensive and slow moving items are generally purchased in bulk quantity.
- Arbitrary Order Quantity is the outcome of the weaknesses of economic order quantity and bulk order quantity. Due to varying market conditions, it is not advisable to always strictly adhere to the economic and bulk order quantities.
- Certain factors viz.; uncertain order from the market, uncertain financial position, uncertain production schedule and uncertain lead time are responsible for the adoption of arbitrary order quantity on the part of the purchase manager.

# Right Time

- The time at which the purchases are to be made is of vital importance. In case of items used regularly, right time means the time when the stock reaches the minimum level. The reorder level of material is fixed for each item under the principle of right time.
- Action for the purchase of new supplies should be immediately initiated, when the material reaches the reorder level. Reorder level for each type of material is calculated by applying the following formula.

- Reorder level = Maximum Consumption x Maximum Reorder Period.  
The materials control department sends the purchase requisition to the purchase department for the purchase of materials. In case materials are required for special jobs, the Purchase Department ensures that the materials are delivered in time.
- Another important factor to be considered is the delivery of materials from stores to production departments. Any under delay in supplying the materials on different jobs delays the production.

# Right Source

- Selecting the right source for the purchase of materials is an important consideration in the purchase procedure. The right source for the procurement of materials is that supplier who can supply the material of right quality as ordered, in right quantity as ordered, at a right time at which the materials were required to be supplied, at an agreed price with the supplier, who is in a position to honour the commitment without much follow-up, who has necessary financial resources and adequate man-power to handle the order and who is well established with higher reputation and proven business integrity.
- The source of material should be located within a reasonable distance from the buyer's organisation. This will minimise the delivery delays, higher transportation charges and improve the personal contact between the buyer and the supplier and enable better after-sales service etc.

- As far as possible the middlemen and brokers should be avoided in the purchase of materials. A direct liaison should be established with the supplier. It would be helpful in improving the quality of the material in future.
- While selecting the supplier certain factors must be kept in mind, viz., location of the supplier, warehousing facilities available with the supplier, relations of the employers with the labour, credit worthiness of the supplier, size of the supplier's firm and quality control observed by the employer etc. A personal visit to prospective supplier's premises will be helpful in assessing the capabilities of the supplier.



# Right Price

- Determination of right price is a difficult task. It is the main object of any organisation to procure the material items at the right price. It is that price which brings the best ultimate value of the money invested in purchasing the materials.
- Deciding the right price of a product depends on variety of factors, viz.; quality, delivery time and ultimate life of the material, demand and supply curve, extent of competition, government restrictions, after sales services, discount offered, and terms of purchase etc. It may be pointed out here that the determination of proper price depends not only on market knowledge but also a clear understanding of the pricing process.

- The buyer should keep in touch himself with the above mentioned factors in the process of determination of price. He must consider that whether a proposed item to be purchased represents the best value for money or not.
- This is known as “value analysis”. The prevailing market prices also provide basis for the price determination. There should be negotiation between the purchase department and the suppliers for the determination of proper price.

# Right Place

- Besides obtaining the materials of the right quality and quantity from the right source at the right price, it should be ensured that the materials are available at the right place. Transportation and material handling costs are greatly affected by the selection of the right place from where the materials are to be acquired. For minimising these costs, selection of right place for the acquisition of material is of utmost importance. If local as well as outside supplier fulfills these conditions, the former should be preferred. The above mentioned principles of purchasing can be summed up as the six R's of purchasing. These are also known as the “essentials” to be followed by the purchasing executive.

