



# Unit 4

## The Purchasing Cycle

### Learning Outcomes

**By the end of this unit the learner will be able to:**

- ✓ Understand the principles of the purchasing cycle

## Unit 4

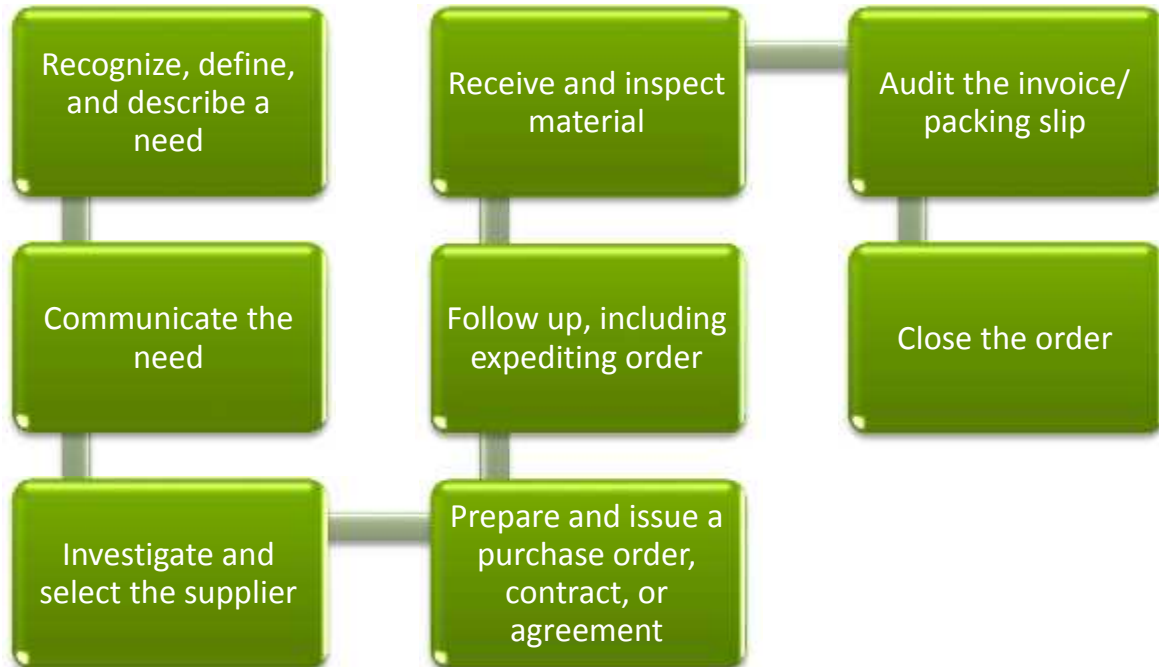
# The Purchasing Cycle

### Cycle Overview

#### The Steps in the Cycle

A purchasing department typically buys lots of different materials and services. Likewise, procedures to complete business will vary somewhat depending on the company, and whether the purchase involves materials, equipment, or services.

However, the essentials in the process remain the same:



#### Additional Points to Consider

In addition to the well-defined steps outlined here, there is considerable **communication** that takes place throughout the process, with numerous touchpoints. Procurement procedures that are created by the company provide the framework for where the work gets accomplished, and remind us that communication must remain open and clear.

In the case of equipment purchases, extra considerations include whether the items will be purchased **outright** (with warranties or service agreements, or without) or **leased** (which is similar to being rented over a set period of time, but with benefits to the procurer like service agreements or trade-in value). As well, equipment can be acquired as **new or used**.

Equipment purchases tend to take place every few years, and may require more authorization levels or steps than other purchases. **Lead time** (the amount of time it takes between deciding that a piece of equipment needs to be purchased and then being able to receive it) is of particular importance in equipment purchases, since some items have to be specially manufactured or acquired from great distances.

In the case of purchasing services, there is a veritable tsunami of outsourcing available. In addition, **expenditures** involving services by private, not for profit, and government organizations continually increase. It's not unusual for services procurement to make up more than **25% of expenditures**. (Services can include software development, engineering, promotions and marketing, equipment maintenance and repair, food and hospitality services, and janitorial care.) Instead of selecting suppliers, the company may issue a request for proposals and consider multiple proposals before initiating the purchase through a well-defined statement of work.

## Identifying a Need

### The Starting Point

In a small business, making a decision to purchase a package of paper can be dealt with simply. You load the last package of paper into the printer, and then stop at a stationery supplier on the way home and pick up a box. However, full retail price is probably not how much you'd like to spend, is it? This is part of the reason that having people knowledgeable about procurement is essential.

The need for a purchase normally starts in an operating department or the inventory control section. The procurement department gets notified of a need either when they receive a purchase requisition or when there is a notice on the material requirements planning (MRP) schedule.

### The Purchase Requisition

A **purchase requisition** is an internal document, and not the same as a **purchase order** (which is an external document). Whether you submit a purchase requisition in paper or electronic form, it is the most common way of making a request. Essential information includes a description of the item, service, or equipment needed; the quantity required; and the date that it is needed by. If your organization uses an electronic format, they can be created, approved (or declined), and forwarded to the procurement department in next to no time.

### Material Requirements Planning Schedule

When it comes to large items such as computers or vehicles, companies will commonly institute a **Material Requirements Planning Schedule**. This allows them to plan and budget ahead for large purchases. It also prevents individuals or departments from requesting items that need to be a part of a larger system. While this can frustrate some individuals (like the person who gets hired to do design work and yet there is no equipment available when they start their new job), it does prevent over-spending. Special arrangements can be made (such as in the case of the designer) so that they have the equipment they need and are able to get their job done.

## Developing a System

If you are the person in the procurement department, you need an efficient system for tracking requests and getting things to people on time. You also might find that people you work with routinely forget to put these requests through at the right time, so you will need to draw some clear boundaries about the process and how they can acquire what they need without every order taking place in a rush, or from a supplier you do not trust.

## Making Connections

**Are you using a manual (written) process or an electronic one?**

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**What do you prefer?**

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**As your company grows, how will this system grow with it?**

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## Researching Your Options

### Identifying Suppliers

Once the need for a purchase has been identified and described, the procurement manager begins to investigate the market and identify potential sources for the materials needed. If the need is for routine items there may be little investigation needed, especially where the procurement and supplier relationship is strong. On the other hand, new items or those with a high purchase price can require considerable research.

If more than one supplier has potential, the procurement manager can start a process of **competitive bidding**. This often takes the form of a Request for Qualifications (RFQ), Request for Proposals (RFP), negotiation, or a combination of these processes.

Depending on the items required, this process can take significant time. Added complexity can arise if items are located offshore, where transportation times, tariffs, and trade agreements all come into consideration. The procurement manager understands these issues, and remains keenly aware that just because they may not know the rules of trade in a particular area, that's no excuse for breaking them.

### Issuing the Purchase Order

Once a supplier has been selected, the procurement department issues a numbered purchase order. The purchase order is clearly worded and carefully prepared, since it becomes a legal and binding contract. If engineering specifications, a statement of work, deliverables, or additional documents are required, they all need to be referenced as part of the purchase order. The purchase order also has to include delivery and shipping information, price, quantity, and all the necessary dates. Finally, the template should include information about contract acceptance, delivery performance (like a fine or price reduction for each day that the delivery is late), shipment rejections, compliance with the law, warranties, what happens in subcontracting, patents/trademarks, and anything else specific to the company or industry. Each company develops its own documentation according to its needs, and it's up to the supplier to read and acknowledge these terms.

### Issuing a Change Order

If the order is placed and then a change is deemed necessary, the purchaser issues a change request, and it follows the same procedures as the original order. Once accepted, the change order can either supplement or replace the original purchase order. Change orders can also be created by the supplier if they are unable to meet the demands of the purchase order.

### Invoice Auditing

Anywhere that people work, there is potential for errors. The more electronic that our warehousing and inventory processes become, the fewer errors we see, but a mistake can and will occur from time to time.

To make sure that the purchaser is comfortable with paying for the materials they actually receive, it's important to have a process where the invoice and shipment are both reviewed together. (This is often

typically required by the accounting department as well.)

The purchaser determines whether the quantity, quality, and types of materials ordered were received, and then they submit the invoice for processing. Auditing invoices and shipments can seem repetitive or mundane, so it's best to find someone who enjoys that level of attention to detail and let them get it done quickly and efficiently. This is not the type of job you can let sit, since your materials could indeed find themselves on the way out of the shipping bay and into the office before they get counted!

## Lessons Learned

You may have heard stories about how a government department paid \$400 for a hammer or \$600 for a toilet seat. While these are ridiculous (yet apparently true) examples, they say a lot about how supply chain management can fail when it's not properly executed. We should set up procurement systems with integrity and checks and balances to make sure it doesn't happen. We should also work with suppliers who demonstrate reliability and honesty.

A lot of purchasing decisions actually take place outside of the procurement department, and that can lead to problems such as higher costs and duplication of effort. When an operations area makes decisions about a large purchase and then simply passes along a "demand" to purchasing to arrange delivery and transportation, that same operations manager can be incurring higher product costs than what the purchasing manager can get. Of course, if the purchasing function is not well integrated in the organization, the operational manager may not even know there is an easier way. This is another example of why it's so important to have procurement integrated throughout the organization, and not have it set up as a standalone area.

Imagine that your company negotiates an excellent rate on cell phones and data. You might have even arranged the contract so that individual users can choose the color of their phone case. You will typically get a good rate on bulk purchases or leasing for this kind of equipment. However, if a single department manager decides to go out on their own because their six-person department wants something specific to their niche, they could be blowing their telecommunications budget in a hurry. They could also breach your contract if you have made an exclusive agreement with a particular supplier.

### Further Reading:

- ✓ *Supply Chain: The Key to World-Class Procurement*. McGraw-Hill.
- ✓ Fisher, Roger, Bruce Patton, and William Ury. 2011. *Getting to Yes*. Penguin.
- ✓ Reinecke, Nicolas, Peter Spiller, Henrique Teixeira, and Drew Ungerman. 2014. *Procurement 20/20: Supply Entrepreneurship in a Changing World*. Wiley.