NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF MANAGEMENT SCIENCES

COURSE CODE: ENT 324

COURSE TITLE: PRINCIPLES OF PURCHASING AND SUPPLY

ENT 324: PRINCIPLES OF PURCHASING AND SUPPLY

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Introduction

ENT 324 Principles of Purchasing and Supply is a one semester, two credit unit course. It is available to all undergraduate programmes either as core course as an elective course in the school of Management Sciences. The course consists of 15 study units, covering such general areas as the nature of purchasing and Supply Management; the conceptual framework; purchasing and supply function; quality assurance activities; supplier selection activities; pricing procedures; management of inventory; Government purchasing; negotiated procurements and expediting and follow – up of order.

This course guide tells you briefly what the course is about, relevant textbooks to consult, and how you can work your way through these materials. It also contains some guidelines on your way through these materials. It also contains some guidelines on your tutor-marked assignments.

WHAT YOU WILL LEARN IN THIS COURSE

The major aim of ENT 324 Principles of Purchasing and Supply is to introduce you to the field of purchasing. The field Procurement and Supply Management is often dynamic, challenging, and rewarding. It can also be frustrating and even disappointing. But it is never dull. By going through this course, you are subjecting yourself to be trained to be equipped with skills and competency to buy. Training takes different shapes. The basic goal of a business activity is the development and manufacturing of products that can be marketed at a profit. This goal is accomplished by the appropriate blending of what management authorities have historically called the 5 M's: Machines; Manpower; Materials; Money and Management. Materials today are the lifeblood in the industry. Materials of the appropriate quality must be available at the right time, in the right quality at the needed location and at an acceptable total cost.

It will help you to make the right choice in the management of flow of materials into manufacturing plant from the vendor or supplier. Therefore, training in Procurement and Supply Management is an integral purpose of the programme for you have been admitted. But if you have had any training already in Procurement and Supply Management, this course can still help to refine your skills.

This course gives an understanding of the primary functions and structural steps of the entire Procurement and Supply Management process. This is because you can spend wisely and pay what you buy It is generally agreed that it is easier to buy well than to sell well. This process is much of practical skill building exercise, which gives you the process of management thinking and way of materials procurement and supply. This management way thinking is a conventionally acceptable and recommended way of approaching Procurement and Supply Management problems in true life situation and the goal is to achieve appropriate blending of machines, manpower, materials, money and management. The goal of the Procurement and Supply Management therefore is to give you or equip you with the knowledge, philosophy, attitude and skill of approaching task of making available materials of the appropriate quantity, in the right quality at the right time, in the right place and at acceptable total cost.

Course Objectives

In order to achieve the aims set out above, the course sets overall objectives. You will also realize that each course unit objectives are always includes at the beginning of each unit. It is advisable to read through their specific objectives before studying through the unit. The following are the broad objective of the course. By striving to meet these objectives, you should have achieved the aims of the course as a whole.

On successful completion of the course, you should be able to:

- Describe the meaning of purchasing and Supply
- Purchasing and supply function;
- Quality assurance activities;
- Supplier selection activities;
- Pricing procedures;
- Management of inventory;
- Government purchasing;
- Negotiated procurements;
- Expediting and follow – up of roder;

WORKING THROUGH THIS COURSE

It will be very essential that you thoroughly read the study units, consult the suggested texts and other relevant materials at your disposal. Most of the units contain self-assignment, which will be assessed by your tutor.

Course Materials

Major components of the course are:
1. Course Guide
2. Study Units
3. Assignment File
4. Presentation schedule

Study Units

There are 15 study units in this course. These are:

Module 1 ……………………………………………………….

Unit 1 The Purchasing Function
Unit 2 Purchasing Guidelines, Terms and Terminologies

Unit 3 General principles of entering into contracts
Unit 4 Supplier's Selection Activities
Unit 5 Pricing Procedures in Procurement and Supply Function

Module 2 ……………………………………………………….

Unit 6 Terms of Payment for Goods

Unit 7 Modes of Purchase, Receipt and Opening of Tenders

Unit 8 Purchasing Practice and Methods (I)

Unit 9 Purchasing Practice and Methods – (II)

Unit 10 Management of Inventory

Module 3 ……………………………………………………….

Unit 11 Negotiated Procurements

Unit 12 Expediting or Follow-Up of Order

Unit 13 Buying Internationally

Unit 14 Managing Purchasing Activities .

Unit 15 Delivery Period, Terms of Delivery, Transportation, Transit Insurance, Delay in Supply, Cancellation of Contract

Set Textbooks

There are no compulsory books for the course. However, you are encouraged to consult some of those listed for further reading at the end of each unit.

Assignment File
The assignment file will be made available to you. You will find all the details of the work you must submit to your tutor for marks. The marks you obtain for this assignment will count towards the final mark you will obtain for this course. Any further information on assignment will be found in the assignment file.

ASSESSMENT
Your performance in this course will be based on two major approaches. First, are the tutor-marked assignments (TMAs). The second method is through a written examination.

Tutor-Marked Assignments (TMAs)
With respect to TMAs, you are expected to apply the information, knowledge and technique gathered during the course. The assignments must be submitted to your tutor for formal assessment in accordance with the laid down rules. The total score obtained in the TMAs will account for 50% of your overall course mark.

There are many TMAs in the course. You should submit any eight to your tutor for assessment. The highest five of the eight assessments will be counted and this credited to your overall course mark.

Final Examination and Grading
At the end of the course, you will need to sit for a final written examination for three hour's duration. This examination will consist of questions, which reflect the types of self-testing, practice exercise and TMAs you have previously encountered. You are advised to prepare adequately for the examination. Since the general board area of the course will be assessed.

Course Marking Scheme
The following table lays out how the actual course marking is broken down:

Assessment	Marks
Eight assignment submitted	Best 4 marks of the eight count @ 10% 40% of course marks.
Final examination	60% of overall course marks.
TOTAL	100% course marks

HOW TO GET THE MOST FROM THIS COURSE

The distance learning system of education is quite different from the traditional University system. Here, the study units replace the University Lecturer, thus conferring a unique advantage to you. For instance, you can read and work through specially designed study materials at your own pace, and at a time and place that suit you best. Hence, instead of listening to lecturer, all you need do is reading.

You should understand right from the on-set that the contents of the course are to be worked at, and understood step be step, and not to be read like a novel. The best way is to read a unit quickly in order to see the general run of the content and then to re-read it carefully, making sure that the content is understood step by step. You should be prepared at this stage to spend a very long time on some units that may look difficult. A paper and pencil is a necessary piece of equipment in your reading.

Tutors and Tutorials

Detailed information about the number of tutorial contact hours provided in support of this course will be communicated to you. You will also be notified of the dates, times, and location of these tutorials, together with the name and phone number of your tutor, as soon as you allocated to a tutorial group.

Your tutor will mark and comment on your assignments, keep a close watch on your progress and on any difficulties you might encounter, and provide assistance to you during the course.

Please do not hesitate to contact your tutor by telephone or e-mail if you need help. The following might be circumstances in which you would find help necessary:

- You do not understand any part of the study units.
- You have difficulty with the self-tests or exercises.
- You have a question or problem with an assignment or with the grading of an assignment.

You should endeavor to attend tutorial classes, since this is the only opportunity at your disposal to experience a physical and personal contact with your tutor, and to ask questions, which are promptly answered. Before attending tutorial classes, you are advised to thoroughly go through the study units, and then prepare a question list. This will afford you the opportunity of participating very actively in the discussions.

SUMMARY

Principles of Purchasing and Supply is an activity directed towards the appropriate blending of what management authorities have historically called the 5 M’s: Machines; Manpower; Materials; Money and Management. Materials today are the lifeblood in the industry. Materials of the appropriate quality must be available at the right time, in the right quality at the needed location and at an acceptable total cost. This is the primary goal of any Procurement and Supply Management functions.

UNIT 1 THE PURCHASING FUNCTION..1

Content

1.0 INTRODUCTION

Every Ministry / Department spends a sizeable amount of its budget for purchasing various types of goods to discharge the duties and responsibilities assigned to it. It is imperative that these purchases are made following a uniform, systematic, efficient and cost effective procedure, in accordance with the relevant rules and regulations of the Government. The Ministries / Departments have been delegated powers to make their own arrangements for procurement of goods under the Delegation of Financial Power Rules, which have to be exercised in conformity with the orders and guidelines issued by competent authorities coverings financial, vigilance, security, safety, countertrade and other regulatory aspects. Without purporting to be a comprehensive compendium of all statutory provisions, rules, regulations, orders and guidelines on the subject of public procurement, this Manual is intended to serve as a portal to enter this vast area and draw attention to basic norms and practices governing public procurement.

2.0 OBJECTIVES

At the end of studying this unit, you should be able to:

a) Comment on the issues leading to the changes in the role of purchasing over time

b) Define the following key terms: i purchasing; ii Procurement; iii Supply chain management; iv Materials Management.

c) Discuss the evolution of sustainable Purchasing Practices

d) Identify and explain the several major types of purchasing managers, buyers, and purchasing agents

e) Outline the functions of purchasing department

f) Distinguish and explain the objectives of purchasing can be viewed from three levels

g) List out the advantages of effective procurement

3.0 THE PURCHASING FUNCTION

3.1 New Angles to Purchasing

In recent years the purchasing and materials function have undergone a complete re-evaluation by business management. Materials management is sometimes described as 'the last goal line' for business manager. Indeed, it is among the last of the specialized business function to be centralized and given the responsibility and the authority for making major contribution to profits. Yet progress in this area of business management is just beginning.

In most business operations today, the cost of materials is the last remaining cost that is truly variable-all other major costs are either fixed or tend to be semi-fixed. Hence, a reduction in the cost of materials per se clearly offers an unusual opportunity for profit improvement. When one consider that materials cost in a typical manufacturing firm represents approximately 50 percent of total cost, the opportunity for profit improvement in the materials area is virtually impossible to match in any other area of business operation.

To date, only most progressive manufacturing firms realize that materials availability, purchasing specifications, fabrication cost, and distribution cost are all factors which impinge on total materials cost. These progressive firms also realise that all materials cost factors must be coordinated and controlled by a systems-oriented materials management department if total materials cost is to be optimized. Regrettably, most manufacturers still have to learn over forty years ago; (1) buying well is as selling well and (2) even the most capable sales efforts cannot compensate for poor purchasing specifications.

Fundamental economic reasons such as those noted above couple with business growing recognition of the superiority of the systems approach to management made possible by continuing advances in electronic data processing, are what essentially guarantee continued development and utilization of materials management.

Once we start to see purchasing as a business process in which many are involved rather than a standalone specialized function, we can start to talk the language of business and leave behind those parochial attitudes which so often act as barriers to getting the job done to maximum advantage.

The debate is now less about "who does what" and more about "ensuring what all is done well". At the same time the role of the purchasing professional throughout the revenue purchase portfolio is changing away solely an administrative 'doing' activity and more to one of providing consultancy service to the purchasing process. If is hoped that this guide will not just end as a another fad but will set out to upgrade and materials management processes.

3.2 Purchasing and Terminologies Defined

Part of the problem stems from the lack of a clear definition about the nature and role of purchasing within organisations. The terms purchasing and procurement are used interchangeable and there is often reference to materials management, logistic, etc. It may therefore be helpful to starting by clarifying some of these terms and concept. ***Purchasing may be defined as follows:***

> *The process by which an individual, a company (or other organisation) contracts with third parties to obtain the goods and services required to fulfil its business objectives in the most timely and cost-effective manner.*

Procurement

Procurement is a term originated by the Armed forces to define one of several supply functions involved in logistic. In the broadest sense, the Armed Forces define "procurement" as including the whole process whereby all classes of resources (people, material, facilities and services) required by the Armed Forces are obtained. Although the term "procurement" originated in military organisation, it has for many years also been adopted and used by American Industry. It is even included in the title of a well-known textbook. In scope, procurement's industrial meaning parallels its military meaning. In both settings, procurement encompasses a wider range of supply activities than does purchasing alone. But for the purpose of this book, *Procurement* is defined as being broader in scope than "purchasing" and includes activities of *strategic* relevance, such as sourcing, negotiating with suppliers and coordination with R&D.

Supply Chain Management

One only need consider the recent scandals surrounding tainted pet food and toys to see how disastrous "supply chain" mistakes can be not only for the purchaser, but also sometimes for an entire country.

A supply chain has been defined as "a network of facilities that procure raw materials, transform them into intermediate goods and then final products, and deliver the products to customers through a distribution system." The management of such a network requires mastery of optimization logistics, or the specific quantity of a good needed at a particular time and price. Clearly, relationships with suppliers that make up these networks are a central component of successful supply chain management. **Supply Chain Management** *(SCM)* is the broadest term mentioned so far. *It includes all of the above and is defined as the planning, steering and controlling of the whole flow of materials and services in a network of collaborating companies.*

Materials Management

Materials management, as practiced in business todady, can be defined as a confederacy of traditional materials activities bound by a common idea – the idea of an integrated management approach to planning, acquisition, conversion, flow and distribution of production materials form the raw-materials state to the finished-product state.

The materials management concept advocates the assignment of all major activities, which contribute to material's cost to a single materials management department. This include the primary responsibilities which are generally found in the purchasing department, plus all other major procurement responsibilities, including inventory management, traffic, receiving, warehousing, surplus and salvage and frequently production planning and control. Some companies also include customer service, scheduling, shipping, materials handling and physical distribution in their definition of materials management.

The specific form of material organisation most appropriate for one company may not be the best form for another company, a brief discussion of two materials activities will illustrate why the unique nature of a specific firm's ;operating activities influences its form of material organisation so heavily. Assume that a plant purchases all the parts, components and subassemblies for the product it manufactures. In this situation, if production were uniform, the production planning schedule and the purchasing schedule would be similar or identical.

Consequently, for this firm to achieve optimal materials and cost control production control should realistically be included in the materials management department. Assume now that a plant manufactures all the parts, components, and subassemblies that are used in turning out its product. In this situation, there may be very little similarity between the production planning and purchasing schedules. Therefore, in this firm, a strong case could be made for locating production control within the production department.

In practice, the theoretical extremes discussed above seldom exist. For most firms the production planning and purchasing schedules overlap significantly. Unfortunately, this frequently produces a continuing source of conflict.

One of the paramount advantages of materials management is that it forces coordination between purchasing and production control. Purchasing and production controls are both responsible to for the on-time delivery of production materials. Division of this authority between two different operating units inevitably led to conflict. When materials do to not arrive on time, production control is seldom satisfied to work through the purchasing department. Frequently, production control personnel proceed to expedite the materials directly with thee supplier. Since the expediting of purchased materials and negotiation with suppliers are basic purchasing responsibilities, conflicts ensues. Such conflict is resolved much more easily when production control and purchasing report to a single boss-the materials manager.

3.3 Evolution of Sustainable Purchasing Practices

In the context of a weak business case and the uneven distribution of power in the chain, sustainable purchasing practices have in the main emanated from experiences of various alternative trading models. These range from private sector schemes in response to market demands, to organisations that have a primary concern for producers rather than consumers, and research institutes and donor development agencies. Probably the most widely understood and popular approach is Fair Trade, particularly the standards and certification systems developed by the Fair-trade Labelling Organisation (FLO) and the practices of Alternative Trading Organisations (ATOs).

FLO aims to improve the conditions of trade for organisations of smallholder producers of tropical commodities by specifying the conditions for Fair-trade production (for both small scale producer organisations and ‘conditions of hired labour’) and importantly trade certification. Fair-trade standards focus on the trading relationship, covering contractual and price issues. ATOs such as Twin Trading and Tradecraft adopt a partnership approach and aim to connect producers and customers through direct relationships, increasing market knowledge, and adding greater value to the primary product.

A number of standards practices were sets for producers based on environmental, social, and economic criteria, assessed by an independent auditor (at producers’ cost), to determine which producers achieve preferred supplier status. Those who meet the sustainability requirements accrue a better deal for their product through the receipt of ‘outright prices’ negotiated directly between co-operatives, private purchase, direct purchase, and long-term contracts of 3-5 years.

The sustainable purchasing practices outlined in Table 1 are ways in which interventions or changes in the current system can address the issue of the distribution of wealth and benefits in the product market. One thing that was clearly evident from the initiatives investigated was the wide range of companies and organisations who in various ways have demonstrated recognition of the need to address issues in commodity supply chains by adopting some of these practices.

The practices and perceived benefits in Table 1 are drawn from a number of sources, including Fair-trade principles, and also elements from recent policy-focused reports on responsible purchasing such as Tradecraft (2006). They represent a set of measures to both shift balances of power in trading relations to ensure that producers appropriate a greater share of margins from the cocoa value chain, and to build sustainability in supply through the employment of longer term strategies that provide enablers such as access to credit, market information, and contracts that commit beyond one season.

Sustainable Purchasing Practice	Perceived Benefit/s of Adoption
'Fair' share of the export price of cocoa to return to the smallholder farmer.	To cover costs of production and provide a sustainable income.[10]
Longer term contractual commitments.	Assist production planning and reduce volatility in prices.
Direct relationships.	Build trust and stability in the chain. Reduce the number of 'middlemen'.
Improved access to affordable credit and pre-harvest finance.	Improve cash flow of farmers to purchase agricultural inputs and cover harvest expenses.
Timely payments and communication with mutually agreed payment terms.	Greater trust and clarity; reduce uncertainty at end of harvest.
Differential pricing and community premium payments.	Creation of greater local capacity through small-scale investments in appropriate technology, diversification initiatives, and community development projects.

Table 1: The sustainable purchasing practices

3.4 Purchasing Managers, Buyers, and Purchasing Agents

Purchasing managers, *buyers*, and *purchasing agents* buy a vast array of farm products, durable and nondurable goods, and services for companies and institutions. They attempt to get the best deal for their company—the highest quality goods and services at the lowest possible cost. They accomplish this by studying sales records and inventory levels of current stock, identifying foreign and domestic suppliers, and keeping abreast of changes affecting both the supply of, and demand for, needed products and materials. Purchasing professionals consider price, quality, availability, reliability, and technical support when choosing suppliers and merchandise. To be effective, purchasing professionals must have a working technical knowledge of the goods or services to be purchased.

There are several major types of purchasing managers, buyers, and purchasing agents. *Wholesale and retail buyers* purchase goods, such as clothing or electronics, for resale. Purchasing agents buy goods and services for use by their own company or organization. *Purchasing agents and buyers of farm products* purchase goods such as grain, Christmas trees, and tobacco for further processing or resale. Purchasing managers usually handle more complicated purchases and may supervise a group of purchasing agents. Purchasing professionals employed by government agencies or manufacturing firms usually are called purchasing directors, managers, or agents; sometimes they are known as contract specialists. Purchasing professionals in government place solicitations for services and accept bids and offers through the Internet. Some purchasing managers, called contract or supply managers, specialize in negotiating and supervising supply contracts.

Purchasing specialists who buy finished goods for resale are employed by wholesale and retail establishments, where they commonly are known as buyers or *merchandise managers*. Wholesale and retail buyers are an integral part of a complex system of distribution and merchandising that caters to the vast array of consumer needs and desires. Wholesale buyers purchase goods directly from manufacturers or from other wholesale firms for resale to retail firms, commercial establishments, and other organizations. In retail firms, buyers purchase goods from wholesale firms or directly from manufacturers for resale to the public.

Buyers largely determine which products their establishment will sell. Therefore, it is essential that they have the ability to predict what will appeal to consumers. If they fail to purchase the right products for resale, buyers jeopardize the profits and reputation of their company.

They keep track of inventories and sales levels, check competitors' sales activities, and watch general economic conditions to anticipate consumer buying patterns. Buyers working for large and medium-sized firms usually specialize in acquiring one or two lines of merchandise, whereas buyers working for small stores may purchase the establishment's complete inventory.

Evaluating suppliers is one of the most critical functions of a purchasing manager, buyer, or purchasing agent. Many firms now run on a lean manufacturing schedule and use just-in-time inventories so any delays in the supply chain can shut down production and potentially cost the firm its customers. Purchasing professionals use many resources to find out all they can about potential suppliers.

The Internet has become an effective tool for searching catalogs, trade journals, industry and company publications, and directories. Purchasing professionals attend meetings, trade shows, and conferences to learn of new industry trends and make contacts with suppliers. They often interview prospective suppliers and visit their plants and distribution centers to assess their capabilities. It is important to make certain that the supplier is capable of delivering the desired goods or services on time, in the correct quantities, and without sacrificing quality. Once all of the necessary information on suppliers is gathered, orders are placed, and contracts are awarded to those suppliers who meet the purchaser's needs. Most of the transaction process is now automated through use of the Internet.

Purchasing professionals often work closely with other employees in a process called “team buying.” For example, before submitting an order, the team may discuss the design of custom-made products with company design engineers, the problems involving the quality of purchased goods with production supervisors, or the issues in shipping with managers in the receiving department. This additional interaction improves the quality of buying by adding different perspectives to the process.

Work environment. Most purchasing managers, buyers, and purchasing agents work in comfortable offices. They frequently work more than the standard 40-hour week, because of special sales, conferences, or production deadlines. Evening and weekend work also is common before holiday and back-to-school seasons for those working in retail trade. Consequently, many retail firms discourage the use of vacation time during peak periods.

3.5 The Function of Purchasing Department

Apart from purchasing per se, a purchase department would have several complementary activities. Menon (1993) stated some of the important ones to include:

1) Market research for new materials and development of new source of supply.

2) Follow-up with suppliers to ensure proper delivery.

3) Quality assurance in respect of supplies made by vendors, (this includes supplier education, visiting the vendor’s factor to ensure in-process quality assurance).

4) Inspection of materials for quality in order to that the specifications are complied with.
5) Development of proper and streamlined systems and procedures relating to the purchasing function to ensure that work is carried out efficiently and at the lowest reasonable operating cost.
6) Co-ordination with in other functions with the materials department like transportation, receiving, store-keeping, inventory control, accounting etc.
7) Co-ordination with the production, sales and finance departments regarding alteration in production schedules or delivery rates, or changes in materials, product or packaging specification.

3.6 Objective of Purchasing

According to Dobler et al (1996), the objectives of purchasing can be viewed from three levels.
i) A very general managerial level,
ii) A more specific functional or operational level, and
iii) A detailed levels at which precise strategic buying plans are formulated.

• From a top managerial perspective, the general objectives have traditionally been expressed as the five rights that management expects the department to achieve i.e. the acquisition of materials: of the right quality, from the right price. In practice, however, the department can rarely fulfill all these equally, because in some buying situations, conflicts inherently exist between some of the objectives. So usually, some trade-offs must be made. From a practical point of view, supply personnel seek a reasonable balance among these elements of the purchasing mix.

• From an operating or functional perspective, an objective broadly becomes a developed set of statements that provide practical and useful targets for decision-making purposes. In these cases, the following broad statement of objectives is suggested:

1) To support company operations with an uninterrupted flow of materials and services. This is the most fundamental of all the purchasing and supply objectives. In a logical sense, this is a key reason for the existence of the department.
2) To buy competitively and wisely. Buying competitively keeps the buyers on the edge of the companies' activities. Buyers should know what's going on in the outside world. They must keep abreast of the forces of demand and supply that regulate price and material availability. They must be aware of the best practices and the latest developments and ultimately buying to the company's best advantage.

3) To keep inventory investment and inventory losses at a practical minimum. The purchasing job is to achieve a reasonable balance between the required level of inventory to support operations and the cost of carrying the inventory.
4) To develop effective and reliable sources of supply.
5) To develop good relationships with the supplier's community and continuing relationships with active suppliers.
Good relationship with suppliers is imperative, and good relationships with potential suppliers are invaluable. The achievement of the objective number 4 above, on a continuing basis, is virtually impossible if mutually satisfactory continuing relationships are not maintained.
6) To maintain sound co-operative relationships with other departments, providing information and advice as necessary to ensure the effective operation of the organisation as a whole.
7) To develop staff, policies, procedures and organisation to ensure the achievement of the foregoing objectives.

It is a truism, however, that the objective of the purchasing department will vary a great deal, depending upon the organisation's policy, complexity, size, operations, etc.
The third level focuses on the detailed objectives that are developed when precise buying plans are made (usually annually) for each major category of materials the firm uses in its operations. These precise set of objectives for each material typically varies because the usage requirements, the operating conditions, and the markets in which each material is purchased usually are different.

3.7 Advantages of Effective Purchasing

Deriving from the above objectives, we might identify the following as being the principal benefits to be gained from the effective management of the procurement process:
(1) Lower prices of materials and items used
(2) Faster inventory turnover
(3) Continuity of supply
(4) Reduced replenishment lead times
(5) Reduced transportation cost
(6) Reduced materials obsolescence
(7) Improved vendor relationships
(8) Better control of quality
(9) Effective administration and immunisation of organisation effort

(10) Maintenance of adequate records and provision of information for the operations managers.

SELF ASSESSMENT EXCERCISE What operational or functional level objective should Purchasing seek to achieve as a business function?

4.0 CONCLUSION

Clearly, the purchase of items and material has relevance in all types of organisation or operating system, since in all such systems there will be some dependence upon the use of physical items. Whilst the principles and objectives of purchasing might also be applied in the acquisition of labour, capital, etc. the purchasing process is concerned primarily with obtaining physical items for use in, and conversion through, the operating system. Most operating system requires such items. Hospitals for example require a regular reliable supply of consumable items such as medicines, sterile equipment, etc. Transport operations are dependent upon adequate supply of consumable materials such as fuel, tyres, etc. Supply organisations naturally are dependent upon an adequate, reliable and efficient supply of those items which are to be passed to customers, whilst manufacturing organisations are entirely dependent upon the supply of consumable and non-consumable materials and items.

5.0 SUMMARY

Purchasing is one of the basic functions common to all types of business enterprises. These functions are so basic because no business can operate without them. As a business function and in terms of naira spent, purchasing is far the biggest spending department of any manufacturing company. Purchased materials consume over half of a manufacturing firm's sales revenue. It is however generally agreed that it is easer to buy well than it is to sell well. Wise purchasing can reduce operational costs appreciably and also improve profitability

6.0 TUTOR-MARKED ASSIGNMENT

There are several major types of purchasing managers, buyers, and purchasing agents. Who are these people and what do they do?

7.0 REFERENCES

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UNIT 2 PURCHASING GUIDELINES, TERMS AND TERMINOLOGIES....13

Content

1.0 INTRODUCTION

In many organisations purchasing remains the least understood and most ineffectively managed of all the business process. Quite apart from the monetary issue and deviating effect on profit forecasts, mistakes can consequently threaten the viability of the enterprise by allowing costs to rise or delaying the introduction of new products into the market place, leading in turn to a loss of competitiveness. Yet management persist with outdated and inappropriate concepts. Why should this be so and what can be done about it? In this section, you will be equipped with the skill of using different terms and terminologies and an appreciation of the basic guidelines in making purchases.

2.0 OBJECTIVE

At end of studying this unit, you should be able to;

1 Use freely and correctly the purchasing terms and terminologies
2 Explain standard tender enquiry documents
3 Outline and comment on the guidelines for public procurement
4 Discuss the fundamental principles of public buying

3.0. PURCHASING GUIDELINES, TERMS AND TERMINOLOGIES

3.1 PURCHASING TERMS AND TERMINOLOGIES

3.1.1 Buy Back Offer

When it is decided with the approval of the competent authority to replace some existing old goods with their newer and better versions/substitutes, the department may trade the existing old goods while purchasing the new ones.

For this purpose, suitable clauses are to be incorporated in the tender enquiry document so that the interested tenderers formulate and submit their tenders accordingly. Provision should also be kept in the tender documents to permit the interested tenderers to inspect the old goods to be traded through this transaction.

Appropriate provision should also be kept in the tender document allowing the purchase organization to reserve its right to trade or not to trade the old goods while purchasing the new ones and the tenderers are to be asked to frame their quotations accordingly covering both the options. Depending on the value and condition of the old goods to be traded, the time frame for as well as the mode of handing them over to the successful tenderer should be decided and relevant details in this regard suitably incorporated in the tender document.

3.1.2 Maintenance Contract

3.1.2 (a) Some goods, especially sophisticated equipment and machinery need proper maintenance for trouble free service. For this purpose, the purchase organization may enter into maintenance contract. It must however be kept in mind that maintenance contract is to start after the expiry of the warranty period, during which period the goods are to be maintained free of cost by the supplier.

3.1.2 (b) Maintenance contract may be entered into either with the manufacturer/supplier of the goods or with a competent and eligible firm, not necessarily the manufacturer/supplier of the goods in question. The purchase organization should decide this aspect on case to case basis on merit. If the maintenance contract is to be entered into with the supplier of the goods, then suitable clauses for this purpose are to be incorporated in the tender enquiry document itself and while evaluating the offers, the cost component towards maintenance of the goods are also to be added in the evaluated tender value on overall basis to decide the inter se ranking of the responsive tenderers. An equipment with a lower quoted price may carry a higher maintenance liability. Therefore, total cost on purchase and maintenance of the equipment over its projected lifecycle should be assessed to consider its suitability for purchase.

However, if the maintenance contract is to be entered into with a competent and eligible supplier separately, then a separate tender enquiry is to be floated for this purpose and tenders evaluated and ranked accordingly for placement of maintenance contract. Here, the supplier of the goods may also quote and its quotation, if received, is to be considered along with other quotations received. While evaluating the tenderers for maintenance of goods covering a longer period (say, more than one year), the quoted prices pertaining to maintenance in future years are to be discounted to the net present value (NPV) as appropriate for comparing the tenders on equitable basis and deciding the lowest evaluated responsive tender.

3.1.2 (c) The details of the services required for maintenance of the goods, the required period of maintenance and other relevant terms & conditions including payment terms are to be incorporated in the tender enquiry document. The terms of payment for the maintenance service will depend on the nature of the goods to be maintained as well as the nature of the services desired. Generally, payment for maintenance is made on half-yearly or quarterly basis.

3.1.2 (d) A suitable provision should be incorporated in the tender enquiry document and in the resultant maintenance contract indicating that the prices charged by the maintenance contractor should not exceed the prevailing rates charged by it from others for similar services. While claiming payment, the contractor is also to give a certificate to this effect in its bill.

3.1.2 (e) If the goods to be maintained are sophisticated and costly, the tender enquiry document should also have a provision for obtaining performance security. The amount of performance security will depend on the nature of the goods, period of maintenance etc. It generally varies from 2.5 % to 5% of the value of the equipment to be maintained.

3.1.2 (f) Sometimes, the maintenance contractor may have to take the goods or some components of the goods to its factory for repair etc. On such occasions, before handing over the goods or components, suitable bank guarantee is to be obtained from the firm to safeguard purchaser's interest.

3.1.2 (g) Sometimes, during the tenure of a maintenance contract, especially with a longer tenure, it may become necessary for the purchase organization to withdraw the maintenance contract due to some unforeseen reasons. To take care of the same, there should be a suitable provision in the tender document and in the resultant contract. A model clause to this effect is provided below:

> "The purchaser reserves its right to terminate the maintenance contract at any time without assigning any reason. The contractor will not be entitled to claim any compensation against such termination. However, while terminating the contract, if any payment is due to the contractor for maintenance services already performed in terms of the contract, the same would be paid to it as per the contract terms".

Depending on the cost and nature of the goods to be maintained, suitable notice period for such cancellation to come into effect is to be provided in the documents.

3.1.3 Turnkey Contract

A turnkey contract is a mix of goods contract and works contract. Generally, in the tender enquiry documents for a turnkey contract, the purchase organization specifies the performance and output required from the plant proposed to be set up and broadly outlines the various parameters it visualizes for the desired plant. The inputs and other facilities, which the purchase organization will provide to the contractor, are also indicated in the tender enquiry document. The contractor is to design the plant and quote accordingly. The responsibility of the contractor will include supplying the required goods, machinery, equipment etc. needed for the plant; assembling, installing and erecting the same at site as needed; commissioning the plant to meet the required output etc., as specified in the tender enquiry documents. While entering into a turn-key contract, Ministry/Department is to follow the relevant instructions prescribed in the Purchase Manual for Goods as well as in the Works Manual.

3.1.4 Disposal of Surplus Goods

With the passage of time, many of the goods purchased by the Ministries/Departments become unserviceable or obsolete. Such goods are classified as surplus goods. The Ministries/Departments should dispose off such surplus goods at the earliest, to avoid unnecessary inventory carrying cost, decrease in resale price of those goods etc.

3.1.5 Computerization of Purchase Work

Every Ministry/Department should attempt to computerize all the areas of purchase management to the maximum extent possible and develop a suitable package for these purpose through a competent IT firm. This will ultimately result in better efficiency, more speed in performing the duties and, also, reduction in the overall expenditure.

3.1.6 Training

Purchase management is a specialized subject and, therefore, the entrusted with purchase work should be adequately trained at the entry level itself to avoid mistakes in tender evaluation, placement of contract, contract management etc., because any mistake in public procurement may cause financial repercussions, operational hold-ups, and unwarranted legal complications for the Ministries / Departments.

In addition to entry level training, the purchase officials should also be sent for in-service training periodically to keep them abreast with the changing scenario and latest techniques of Purchase Management taking place within as well as outside the country.

3.1.7 Beyond the Manual

The important and significant areas of Public Buying have been covered in this Manual. A situation may, however crop up in a purchase case for which no solution may be readily available in this Manual. In such a situation, the Ministries/Departments may seek advice and guidance from the Central Purchase Organization (e.g.DGS&D) and/or from the Ministry of Law.

3.1.8 Definition of Goods

The term 'goods' used in this Manual applies generally to all articles, material, commodities, livestock, furniture, fixtures, raw material, spares, instruments, machinery, equipment, industrial plant etc. purchased or otherwise acquired for the use of Government but excluding books, publications, periodicals, etc. for a library.

3.2 Standard Terminology and Abbreviations

Standard terminology has been adopted in this book. In certain areas, there may be two or more widely used terminologies bearing the same meaning as mentioned below:

i) Tender, Bid, Quotation. (Meaning: offer received from a supplier)

ii) Tenderer, Bidder. (Meaning: an entity who seeks to supply goods by sending tender/bid)

iii) Tender Enquiry Document, Tender Document, Bidding Document. (Meaning: a detailed document issued by the purchaser specifying his needs and the requirements that a potential tenderer/bidder must meet).

iv) Notice Inviting Tenders, Invitation for Bids (Meaning: advertisement containing brief details of the requirement).

v) Earnest Money Deposit, Bid Security. (Meaning: monetary guarantee furnished by a tenderer along with its tender)

vi) Security Deposit, Performance Security. [Meaning: monetary guarantee furnished by the successful tenderer for due performance of the contract concluded with it.]

Standard Abbreviations have been used in this book. Some important abbreviations are listed below for ready reference:

ACASH	Association of Corporations and APEX Societies of Handlooms
A/T	Acceptance of Tender
ATI	Advertised Tender Enquiry
BG	Bank Guarantee
BL	Bill of Lading
CD	Custom Duty
CIF	Cost, Insurance & Freight
CIP	Carriage and Insurance Paid
CPSU	Central Public Sector Undertaking
DGS&D	Directorate General of Supplies & Disposals
DP	Delivery Period
ED	Excise Duty
EMD	Earnest Money Deposit
FAS	Free Alongside Ship
FM	Force Majeure
FOB	Free On Board
FOR	Free On Rail
INCOTERMS	International Commercial Terms
KVIC	Khadi Village Industries Commission
LC	Letter of Credit
LD-	Liquidated Damages
LPP	Last Purchase Price
LSI	Large Scale Industries
LTI	Limited Tender Enquiry

NSIC	National Small Scale Industries Corporation
NTH	National Test House
PO	Purchase Order
PSU	Public Sector Undertaking
RC	Rate Contract
RR	Railway Receipt
SO	Supply Order
SSI	Small Scale Industries
ST	Sales Tax
STI	Single Tender Inquiry
TPC	Tender Purchase Committee
VAT	Value Added Tax
WDO	Women's Development Organization

3.2.1 Standard Tender Enquiry Documents

The Ministries / Departments should use standard forms of tender enquiry documents and contracts in line with the extant rules, regulations, directives, procedures etc. A set of standard documents may be kept updated for this purpose by each office, broadly following the standard documents prescribed by higher authorities and customizing these standard templates to suit specific requirements. Supervisory authorities would prescribe the kind of alterations permitted in the standard templates and the cases where deviations from the standard provisions can be made with appropriate legal and financial advice.

3.3 GUIDDELINES FOR PUBLIC PROCUREMENT

Transparency, Competition, Fairness and Elimination of Arbitrariness Public buying should be conducted in a transparent manner to bring competition, fairness and elimination of arbitrariness in the system. This will enable the prospective tenderers to formulate competitive tenders with confidence. The following are some important measures to achieve the same and, thus, secure best value for money:

(a) The text of the tender document should be user-friendly, selfcontained, comprehensive, unambiguous, and relevant to the objective of the purchase. The use of terminology used in common parlance in the industry should be preferred.

(b) The specifications of the required goods should be framed giving sufficient details in such a manner that it is neither too elaborately restrictive as to deter potential tenderers or increase the cost of purchase nor too sketchy to leave scope for sub-standard supply. The specifications must meet the essential requirements of the user department. Efforts should also be made to use standard specifications, which are widely known to the industry.

(c) The tender document should clearly mention the eligibility criteria to be met by the tenderers such as minimum level of experience, past performance, technical capability, manufacturing facilities, financial position, ownership or any legal restriction etc.

(d) Restrictions on who is qualified to tender should conform to extant Government policies and be judiciously chosen so as not to stifle competition amongst potential tenderers.

(e) The procedure for preparing and submitting the tenders; deadline for submission of tenders; date, time & place of public opening of tenders; requirement of earnest money and performance security; parameters for determining responsiveness of tenders; evaluating and ranking of tenders and criteria for full or partial acceptance of tender and conclusion of contract should be incorporated in the tender enquiry in clear terms.

(f) Tenders should be evaluated in terms of the criteria already incorporated in the tender document, based on which tenders have been received. Any new condition, which was not incorporated in the tender document, should not be brought into consideration while evaluating the tenders.

(g) Sufficient time should be allowed to the tenderers to prepare and submit their tenders.

(h) Suitable provisions should be kept in the tender document allowing the tenderers reasonable opportunity to question the tender conditions, tendering process, and/or rejection of its tender and the settlement of disputes, if any, emanating from the resultant contract.

(i) It should be made clear in the tender document that tenderers are not permitted to alter or modify their tenders after expiry of the deadline for receipt of tender till the date of validity of tenders and if they do so, their earnest money will be forfeited.

(j) Negotiations with the tenderers must be severely discouraged. However, in exceptional circumstances, where price negotiations are considered unavoidable, the same may be resorted to, but only with the lowest evaluated responsive tenderer, and that too with the approval of the competent authority, after duly recording the reasons for such action.

(k) The name of the successful tenderer to whom the supply contract is awarded should be appropriately notified by the purchase organization for the information of general public, including display at notice board, periodical bulletins, website etc.

3.3.1 Efficiency, Economy and Accountability

Public procurement procedures must conform to exemplary norms of best practices to ensure efficiency, economy and accountability in the system. To achieve this objective, the following key areas should be taken care of:

(i) To reduce delays, each Ministry / Department should prescribe appropriate time frame for each stage of procurement; delineate the responsibility of different officials and agencies involved in the purchase process and delegate, wherever necessary, appropriate purchase powers to the lower functionaries with due approval of the competent authority.

(ii) Each Ministry / Department should ensure conclusion of contract within the original validity of the tenders. Extension of tender validity must be discouraged and resorted to only in absolutely unavoidable, exceptional circumstances with the approval of the competent authority after duly recording the reasons for such extension.

(iii) The Central Purchase Organizations should bring into the rate contract system more and more common user items, which are frequently needed in bulk by various Ministries / Departments.

The Central Purchase Organizations should also ensure that the rate contracts remain available without any break.

3.4 Fundamental Principles of Public Buying

It may be useful to refer to the following provisions in the General Financial Rules, 2005:

Rule 1► Fundamental principles of public buying

Every authority delegated with the financial powers of procuring goods in public interest shall have the responsibility and accountability to bring efficiency, economy, transparency in matters relating to public procurement and for fair and equitable treatment of suppliers and promotion of competition in public procurement. The procedure to be followed in making public procurement must conform to the following yardsticks :-

> *(i) the specifications in terms of quality, type etc., as also quantity of goods to be procured, should be clearly spelt out keeping in view the specific needs of the procuring organizations. The specifications so worked out should meet the basic needs of the organization without including superfluous and non-essential features, which may result in unwarranted expenditure. Care should also be taken to avoid purchasing quantities in excess of requirement to avoid inventory carrying costs;*
>
> *(ii) offers should be invited following a fair, transparent and reasonable procedure;*
>
> *(iii) the procuring authority should be satisfied that the selected offer adequately meets the requirement in all respects;*
>
> *(iv) the procuring authority should satisfy itself that the price of the selected offer is reasonable and consistent with the quality required;*

(v) at each stage of procurement the concerned procuring authority must place on record, in precise terms, the considerations which weighed with it while taking the procurement decision.

Rule 2► Authorities competent to purchase goods and their Purchase Powers

2.1 An authority which is competent to incur contingent expenditure may sanction the purchase of goods required for use in public service following the general procedure contained in this Manual.

2.2 A demand should not be split into small quantities for the sole purpose of avoiding the necessity of taking approval of the higher authority required for sanctioning the purchase of the original demand.

Rule 3► Purchase through a Central Purchase Organization

In case a Ministry / Department does not have the required expertise or manpower, it may send its indent to the Central Purchase Organization with the approval of its Secretary. The indent form to be utilized for this purpose will be as per the standard form evolved by the Central Purchase Organization.

Rule 4► Price Preference

As per the extant rules, when acceptable offers are received against an *ad-hoc* requirement of unreserved goods from various categories of suppliers, including Large Scale Sector, Public Sector Undertakings and Small Scale Sector, the offer from the Small Scale Sector, which is registered with National Small Industries Corporation (NSIC) or with Directorate General of Supply and Disposal (DGS&D) is entitled for price preference up to 15% over the offer of Large Scale Sector and 5% over the offer of Public Sector Undertaking, provided the offers under consideration are otherwise clear for acceptance in all respects.

(Example: The evaluated cost of the lowest acceptable offer, which is from a Large Scale Sector is =N=100/-. The evaluated cost of an acceptable offer from a Small Scale Unit, which is registered with NSIC / DGS&D is =N=115/-. This SSI is entitled to get the order at its quoted price).

However, the price preference admissible to the SSI unit is not mandatory. It is to be decided separately for each tender on merits of each case, in consultation with Finance, and a mention to that effect should be made in the Notice Inviting Tenders (NIT)/Request for Proposal (RFP). The price preference is accorded to the deserving SSI units as an incentive to grow; but it should not promote inflation, profiteering or misuse of SSI units as conduits. In case the SSI unit in view has established itself as a supplier of the required goods on competitive terms and enjoys advantage(s) over Large Scale Sector, no price preference need be considered.

Where the NSIC / State Development Corporations themselves quote on behalf of some SSI units, such offers will be considered as offers from SSI units registered with the DGS&D/NSIC. An SSI Unit will not get any price preference over another SSI Unit.

Price preference facility to SSI Units will, however, not apply to the procurement of all goods for example, drug items, medical and electro-medical equipment, requirements of defence, where inspection is to be carried out by the defence Inspection organization, items where technical competence, capacity and manufacturing facilities are required to be verified before placement of order and other similar goods. Before considering any price preference to Small Scale Sector, the purchase organization should check the latest directives in this regard for necessary action.

4.0 CONCLUSION

Appropriate provision should be kept in the tender document allowing the purchase organization to reserve its right to trade or not to trade the old goods while purchasing the new ones and the tenderers are to be asked to frame their quotations accordingly covering both the options. Depending on the value and condition of the old goods to be traded, the time frame for as well as the mode of handing them over to the successful tenderer should be decided and relevant details in this regard suitably incorporated in the tender document.

5.0 SUMMARY

In this unit we have different considered a number of terms and terminologies and an appreciation of the basic guidelines in making purchases. Standard terminology has been adopted in this book. In certain areas, there may be two or more widely used terminologies bearing the same meaning.

And finally, public procurement procedures must conform to exemplary norms of best practices to ensure efficiency, economy and accountability in the system.

6.0 TUTOR MARKED ASSIGNMENT

Public procurement procedures must conform to exemplary norms of best practices to ensure efficiency, economy and accountability in the system

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UNIT 3 GENERAL PRINCIPLES OF ENTERING INTO CONTRACTS.....24

Content

1.0 INTRODUCTION

The purchasing function comprises the essential activities associated with the acquisition of the materials, services, and equipment used in the operation of an organisation. During the early years, the purchasing function used to be handled in a reactive, staff support manner. Subsequently, it was conducted more professionally with a managerial emphasis. Management is said to involve getting a job done through people and central to the discussion of management are the managerial functions of planning, organising, directing and controlling. These functions are relevant regardless of the type of organisation or the level of management with which one is concerned. This unit exposes you to the issues involved in the management of contract particularly the general principles for contract.

2.0 OBJECTIVE

At the end of studying this unit, you should be able to;

1 Highlight and discuss the elementary legal practices that pertains to purchase of goods

2 Outline and explain in clear term the general principles that should be observed while entering into contracts

3.0 GENERAL PRINCIPLES OF ENTERING INTO CONTRACTS

3.1 Elementary Legal Practices

The elements and principles of contract law and the meaning and import of various legal terms used in connection with the contracts are available in the Company and Allied Matters decree of 1990 in Nigeria read with the Sale of Goods Act, 1930. Some of the salient principles relating to contracts are set out briefly in this unit.

3.1.1 **What is a Contract?**

The proposal or offer when accepted is a promise, a promise and every set of promises forming the consideration for each other is an agreement, and an agreement if made with free consent of parties competent to contract, for a lawful consideration and with a lawful object is a contract.

3.1.2 **Proposal or Offer:** When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of the other to such act or abstinence, he is said to make a proposal or offer. In a sale or purchase by tender, the tender signed by the tenderer is the proposal. The invitation to tender and instructions to tenderers do not constitute a proposal.

3.1.3 **Acceptance of the Proposal:** When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise.

3.1.4 **What agreements are contracts:** An agreement is a contract enforceable by law when the following are satisfied. A defect affecting any of these renders a contract un-enforceable.

(a) Competency of the parties

(b) Freedom of consent of both parties

(c) Lawfulness of consideration

(d) Lawfulness of object

3.2 Competency of Parties

Under law any person who has attained majority and is of sound mind or not debarred by law to which he is subject, may enter into contracts. It, therefore, follows that minors and persons of unsound mind cannot enter into contracts nor can insolvent person do so.

3.2.1 Categories of persons and bodies who are parties to the contract may be broadly sub-divided under the following heads: -

(a) Individuals

(b) Partnerships

(c) Limited Companies

(d) Corporations other than limited companies

(a) Contracts with Individuals: Individuals tender either in their own name or in the name and style of their business. If the tender is signed by any person other than the concerned individual, the authority of the person signing the tender on behalf of another must be verified and a proper power of attorney authorizing such person should be insisted on. In case, a tender is submitted in a business name and if it is a concern of an individual, the constitution of the business and the capacity of the individual must appear on the face of the contract and the tender signed by the individual himself as proprietor or by his duly authorized attorney.

(b) Contracts with Partnerships: A partnership is an association of two or more individuals formed for the purpose of doing business jointly under a business name. It is also called a firm. It should be noted that a partnership is not a legal entity by itself, apart from the individuals constituting it. A partner is the implied authority to bind the firm in a contract coming in the purview of the usual business of the firm. The implied authority of a partner, however, does not extend to enter into arbitration agreement on behalf of the firm. While entering into a contract with partnership firm care should be taken to verify the existence of consent of all the partners to the arbitration agreement.

(c) Contracts with Limited Companies: Companies are association of individuals registered under Companies Act in which the liability of the members comprising the association is limited to the extent of the shares held by them in such companies. The company, after its incorporation or registration, is an artificial legal person which has an existence quite distinct and separate from the members of shareholders comprising the same. A company is not empowered to enter into a contract for purposes not covered by its memorandum of association; any such agreement in excess of power entered into the company is void and cannot be enforced.

Therefore, in cases of doubt, the company must be asked to produce its memorandum for verification or the position may be verified by an inspection of the memorandum from the office of the Registrar of Companies before entering into a contract. Normally, any one of the Directors of the company is empowered to present the company. Where tenders are signed by persons other than Directors or authorized Managing Agents, it may be necessary to examine if the person signing the tender is authorized by the company to enter into contracts on its behalf.

(d) Corporation other than Limited Companies: Associations of individuals incorporated under statutes such as Trade Union Act and Cooperative Societies Act are also artificial persons in the eye of law and are entitled to enter into such contracts as are authorized by their memorandum of association. If any contract has to be entered into with any one or such corporations or associations, the capacity of such associations to enter into contract should be verified and also the authority of the person coming forward to represent the said Association.

3.3 Consent of both Parties

Two or more persons are said to consent when they agree upon the same thing in the same sense. When two persons dealing with each other have their minds directed to different objects or attach different meanings to the language which they use, there is no agreement. The misunderstanding which is incompatible with agreement, may occur in the following cases: -

(a) When the misunderstanding relates to the identity of the other party to the agreement;

(b) When it relates to the nature or terms of the transactions;

(c) When it related to the subject matter of the agreement.

3.4 Free consent of both Parties

3.4.1 The consent is said to be free when it is not caused by coercion, undue influence, fraud, mis-representation or mistake. Consent is said to be so caused when it would not have been given but for the existence of coercion, undue influence, fraud, mis-representation or mistake. When consent to an agreement is caused by coercion, undue influence, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was caused. A party to a contract, whose consent was caused by fraud or misrepresentation may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representations made had been true.

3.4.2 In case consent to an agreement has been given under a mistake, the position is slightly different. When both the parties to an agreement are under a mistake as to a matter essential to the agreement, the agreement is not voidable but void. When the mistake is unilateral on the part of one party only, the agreement is not void.

3.4.3 Distinction has also to be drawn between a mistake of fact and a mistake of law. A contract is not void because it was caused by a mistake as to any law in force in India but a mistake as to law not in force in India has the same effect as a mistake of fact.

3.5 Consideration

Consideration is something which is advantageous to the promisor or which is onerous or disadvantageous to the promisee. Inadequacy of consideration is, however, not a ground avoiding the contract. But an act, forbearance or promise which is contemplation of law has no value is no consideration and likewise an act or a promise which is illegal or impossible has no value.

3.6 Lawfulness of object

The consideration or object of an agreement is lawful, unless it is forbidden by law or is of such a nature that if permitted, it would defeat the provisions of any law, or is fraudulent or involves or implies injury to the fraudulent property of another or the court regards it as immoral or opposed to public policy. In each of these cases the consideration or object of an agreement is said to be unlawful.

3.7 Communication of an Offer or Proposal

The communication of a proposal is complete when it comes to the knowledge of the person to whom it is made. A time is generally provided in the tender forms for submission of the tender. Purchaser is not bound to consider a tender, which is received beyond that time.

3.8 Communication of Acceptance

A date is invariably fixed in tender forms upto which tenders are open for acceptance. A proposal or offer stands revoked by the lapse of time prescribed in such offer for its acceptance. If, therefore, in case it is not possible to decide a tender within the period of validity of the offer as originally made, the consent of the tenderer firm should be obtained to keep the offer open for further period or periods.

3.8.1 The communication of an acceptance is complete as against the proposer or offerer, where it is put in the course of transmission to him, so as to be out of the power of the acceptor, and it is complete as against the acceptor when it comes to the knowledge of the proposer or offerer. The medium of communication in government contracts is generally by post and the acceptance is, therefore, complete as soon as it is posted. So that there might be no possibility of a dispute regarding the date of communication of acceptance, it should be sent to the correct address by some authentic foolproof mode like registered post acknowledgement due, etc.

3.9 Acceptance to be identical with Proposal

If the terms of the tender or the tender, as revised, and modified, are not accepted or if the terms of the offer and the acceptance are not the same, the acceptance remains a mere counter offer and there is no concluded contract. It should, therefore, be ensured that the terms incorporated in the acceptance are not at variance with the offer or the tender and that none of the terms of the tender are left out. In case, uncertain terms are used by the tenderers, clarifications should be obtained before such tenders are considered for acceptance. If it is considered that a counter offer should be made, such counter offer should be carefully drafted, as a contract is to take effect on acceptance thereof.

If the subject matter of the contract is impossible of fulfillment or is in itself in violation of law such contract is void.

3.10 Withdrawal of an Offer or Proposal

A tenderer firm, who is the proposer may withdraw its offer at any time before its acceptance, even though the firm might have offered to keep the offer open for a specified period. It is equally open to the tenderer to revise or modify his offer before its acceptance. Such withdrawal, revision or modification must reach the accepting authority before the *date and time of opening of tender*.

No legal obligations arise out of such withdrawal or revision or modification of the offer as a simple offer is without a consideration. Where, however, a tenderer agrees to keep his offer open for a specified period for a consideration, such offers cannot be withdrawn before the expiry of the specified date. This would be so where earnest money is deposited by the tenderer in consideration of his being supplied the subsidiary contract and withdrawal of offer by the tenderer before the specified period would entitle the purchaser to forfeit the earnest money.

3.11 Withdrawal of Acceptance

An acceptance can be withdrawn before such acceptance comes to the knowledge of the tenderer. A telegraphic revocation of acceptance, which reaches the tenderer before the letter of acceptance, will be a valid revocation.

3.12 Changes in terms of a concluded Contract

No variation in the terms of a concluded contract can be made without the consent of the parties. While granting extensions or making any other variation, the consent of the contractor must be taken. While extensions are to be granted on an application of the contractor, the letter and spirit of the application should be kept in view in fixing a time for delivery.

3.13 Discharge of Contracts

A contract is discharged or the parties are normally freed from the obligation of a contract by due performance of the terms of the contract. A contract may also be discharged: -

(a) **By mutual agreement:** If neither party has performed the contract, no consideration is required for the release. If a party has performed a part of the contract and has undergone expenses in arranging to fulfill the contract it is necessary for the parties to agree to a reasonable value of the work done as consideration for the value.

(b) **By breach:** In case a party to a contract breaks some stipulation in the contract which goes to the root of transaction, or destroys the foundation of the contract or prevents substantial performance of the contract, it discharges the innocent party to proceed further with the performance and entitles him to a right of action for damages and to enforce the remedies for such breach as provided in the contract itself. A breach of contract may, however, be waived.

(c) **By refusal of a party to perform:** On a promisor's refusal to perform the contract or repudiation thereof even before the arrival of the time for performance, the promisee may at his option treat the repudiation as an immediate breach putting an end to the contract for the future. In such a case the promisee has a right of immediate action for damages.

(d) **In a contract where there are reciprocal promises:** If one party to the contract prevents the other party from performing the contract, the contract may be put to an end at the instance of the party so prevented and the contract is thereby discharged.

3.14 Stamping of Contracts

Under the sales of goods act, an agreement or memorandum of agreement for or relating to the sale of goods or merchandise exclusively is exempt from payment of stamp duty. (A NOTE OR MEMORANDUM sent by a Broker or Agent to his principal intimating the purchase or sale on account of such principal is not so exempt from stamp duty.) The Stamp Act provides that no Stamp Duty shall be chargeable in respect of any instrument executed by or on behalf of or in favour of the Government in cases where but for such exemption Government would be liable to pay the duty chargeable in respect of such instrument.

3.15 Contract Effective Date

The date of commencement of the obligations under the contract on the parties to a contract is referred as the contract effective date. This date should be invariably indicated in each contract, as per agreed terms and conditions. The Ministries/Departments are advised to set the effective date to be a date after the following:

(i) Date of signing of the contract.

(ii) Furnishing of performance bond in terms of performance security.

(iii) Receipt of Bank Guarantee for advance payment.

(iv) Obtaining Export Licence for supply of stores by seller and confirmation by the buyer.

(v) Receipt of End User's Certificate. The supplier shall provide the End User's Certificate within 30 days of the signing of the contract.

3.16 GENERAL PRINCIPLES FOR CONTRACT

The following general principles should be observed while entering into contracts:

(1) The terms of contract must be precise, definite and without any ambiguities. The terms should not involve an uncertain or indefinite liability, except in the case of a cost plus contract or where there is a price variation clause in the contract.

(2) Standard forms of contracts should be adopted wherever possible, with such modifications as are considered necessary in respect of individual contracts. The modifications should be carried out only after obtaining financial and legal advice.

(3) In cases where standard forms of contracts are not used, legal and financial advice should be taken in drafting the clauses in the contract.

(4) (a) A Ministry or Department may, at its discretion, make purchases of value up to thousands of naira by issuing purchase orders containing basic terms and conditions.

(b) In respect of Works Contracts, or Contracts for purchases valued between millions and billions of naira, where General Conditions of Contract (GCC), Special Conditions of Contract (SCC) and scope of work, the letter of acceptance will result in a binding contract.

(c) In respect of contracts for works with estimated value of millions of naira or above or for purchase above billions of naira, a Contract document should be executed, with all necessary clauses to make it a self-contained contract. If however, these are preceded by Invitation to Tender, accompanied by GCC and SCC, with full details of scope and specifications, a simple one page contract can be entered into by attaching copies of the GCC and SCC, and details of scope and specifications, Offer of the Tenderer and Letter of Acceptance.

(d) Contract document should be invariably executed in cases of turnkey works or agreements for maintenance of equipment, provision of services etc.

(5) No work of any kind should be commenced without proper execution of an agreement as given in the foregoing provisions.

(6) Contract document, where necessary, should be executed within 21 days of the issue of letter of acceptance. Non-fulfilment of this condition of executing a contract by the Contractor or Supplier would constitute sufficient ground for annulment of the award and forfeiture of Earnest Money Deposit (EMD).
(7) Cost plus contracts should ordinarily be avoided. Where such contracts become unavoidable, full justification should be recorded before entering into the contract. Where supplies or special work covered by such cost plus contracts have to continue over a long duration, efforts should be made to convert future contracts on a firm price basis after allowing a reasonable period to the suppliers / contractors to stabilize their production /execution methods and processes.

Explanation: A cost plus contract means a contract in which the price payable for supplies or services under the contract is determined on the basis of actual cost of production of the supplies or services concerned plus profit either at a fixed rate per unit or at a fixed percentage on the actual cost of production.

(8) (a) Price Variation Clause can be provided only in long-term contracts, where the delivery period extends beyond 18 months. In short-term contracts firm and fixed prices should be provided for. Where a price variation clause is provided, the price agreed upon should specify the base level viz, the month and year to which the price is linked, to enable variations being calculated with reference to the price levels prevailing in that month and year.

(b) A formular for calculation of the price variations that have taken place between the Base level and the Scheduled Delivery Date should be included in this clause. The variations are calculated by using indices published by Governments or Chambers of Commerce periodically.

(c) The Price variation clause should also specify cut off dates for material and labour, as these inputs taper off well before the scheduled Delivery Dates.

(d) The price variation clause should provide for a ceiling on price variations, particularly where escalations are involved. It could be a percentage per annum or an overall ceiling or both. The buyer should ensure a provision in the contract for benefit of any reduction in the price in terms of the price variation clause being passed on to him.

(e) The clause should also stipulate a minimum percentage of variation of the contract price above which price variations will be admissible (e.g. where resultant increase is lower than two per cent. no price adjustment will be made in favour of the supplier).

(f) Where advance or stage payments are made there should be a further stipulation that no price variations will be admissible on such portions of the price, after the dates of such payment.

(g) Where deliveries are accepted beyond the scheduled Delivery Date subject to levy of liquidated damages as provided in the Contract, the liquidated damages (if a percentage of the price) will be applicable on the price as varied by the operation of the Price variation clause.

(h) No price variation will be admissible beyond the original Scheduled Delivery Date for defaults on the part of the supplier.

(i) Price variation may be allowed beyond the original Scheduled Delivery Date, by specific alteration of that date through an amendment to the contract in cases of Force Majeure or defaults by Government.

(j) Where contracts are for supply of equipment, goods etc, imported (subject to customs duty and foreign exchange fluctuations) and / or locally manufactured (subject to excise duty and other duties and taxes), the percentage and element of duties and taxes included in the price should be specifically stated, along with the selling rate of foreign exchange element taken into account in the calculation of the price of the imported item. The mode of calculation of variations in duties and taxes and Foreign exchange rates and the documents to be produced in support of claims for such variations should also be stipulated in the Contract.

(k) The clause should also contain the mode and terms of payment of the price variation admissible.

(9) Contracts should include provision for payment of all applicable taxes by the contractor or supplier.

(10) “Lumpsum’ contracts should not be entered into except in cases of absolute necessity. Where lumpsum contracts become unavoidable, full justification should be recorded. The contracting authority should ensure that conditions in the lumpsum contract adequately safeguard and protect the interests of the Government.

(11) Departmental issue of materials should be avoided as far as possible. Where it is decided to supply materials departmentally, a schedule of quantities with the issue rates of such material as are required to execute the contract work should form an essential part of the contract.

(12) (a) In contracts where government property is entrusted to a contractor either for use on payment of hire charges or for doing further work on such property, specific provision for safeguarding

government property (including insurance cover) and for recovery of hire charges regularly, should be included in the contracts.

(b) Provision should be made in the contract for periodical physical verification of the number and the physical condition of the items at the contractor's premises. Results of such verification should be recorded and appropriate penal action taken where necessary.

(13) Copies of all contracts and agreements for purchases of the value of Millions of naira and above, and of all rate and running contracts entered into by civil departments of the Government other than the departments like the Directorate General of Supplies and Disposals for which a special audit procedure exists, should be sent to the Audit Officer and /or the Accounts officer as the case may be.

(14) (a) The terms of a contract, including the scope and specification once entered into, should not be materially varied.

(b) Wherever material variation in any of the terms or conditions in a contract becomes unavoidable, the financial and other effects involved should be examined and recorded and specific approval of the authority competent to approve the revised financial and other commitments obtained, before varying the conditions.

(c) All such changes should be in the form of an amendment to the contract duly signed by all parties to the contract.

(15) Normally no extensions of the scheduled delivery or completion dates should be granted except where events constituting force majeure, as provided in the contract, have occurred or the terms and conditions include such a provision for other reasons. Extensions as provided in the contract may be allowed through formal amendments to the contract duly signed by parties to the contract.

(16) All contracts shall contain a provision for recovery of liquidated damages for defaults on the part of the contractor.

(17) A warranty clause should be incorporated in every contract, requiring the supplier to, without charge, repair or rectify defective goods or to replace such goods with similar goods free from defect. Any goods repaired or replaced by the supplier shall be delivered at the buyers premises without costs to the buyer.

(18) All contracts for supply of goods should reserve the right of Government to reject goods which do not conform to the specifications.

4.0 CONCLUSION

There is a growing realisation of the specialised nature of the purchasing function. No longer is purchasing like the buying of the olden days. Purchasing has developed into a science and has its own rules, conventions and practices and uses all the processes of management that make it contribute effectively to the company's profits the question of organisational importance. The first assumption is that purchasing is a specialized activity. If this is accepted, then it follows that all purchasing activities in the company should be concentrated in this specialist department.

5.0 SUMMARY

In this unit, we have discussed issues related to the general principles of entering into contracts with specific focus on the elementary Legal Practices and the general principles for contract.

he elements and principles of contract law and the meaning and import of various legal terms used in connection with the contracts are available in the Company and Allied Matters decree of 1990 in Nigeria read with the Sale of Goods Act, 1930.

Companies are association of individuals registered under Companies Act in which the liability of the members comprising the association is limited to the extent of the shares held by them in such companies. The company, after its incorporation or registration, is an artificial legal person which has an existence quite distinct and separate from the members of shareholders comprising the same. A company is not empowered to enter into a contract for purposes not covered by its memorandum of association; any such agreement in excess of power entered into the company is void and cannot be enforced.

6.0 TUTOR MARKED ASSIGNMENTS

Outline and explain the general principles your company has put in place to be observed while entering into contracts

7.0 REFERENCES

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UNIT 4: SUPPLIER'S SELECTION ACTIVITIES...........................36

Contents

1.0 INTRODUCTION

Suppliers are major resources for manufacturers and traders alike. It would not be possible operate to without them. An adequate supplier base is essential to the economic wellbeing of a firm. Perhaps, it would be reasonable to argue that the most important purchasing decisions are concerned with selecting the right source of supplier; that is, if the correct source decision is made in a particular instance, then the buying company would receive the right goods in the right condition, in the right quality, at the right time and at the right price. Selection and management of the right supplier is the key to obtaining the desired level of quality, on time and at the right price to meet up with the company's purchasing objectives and policies. The management of the supply market however requires advance planning, forethought and the quality to make some decisions. Sourcing in purchasing has gone beyond simply picking a supplier for each order in isolation.

1) It involves continuing relationships, both with preferred source which are actually supplying goods and services, and with potential source which may have been passed over for the present but are still in the running.
2) It involves decisions about how to allocate the available business, and what terms to do business on.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

• State and discuss factors in Supplier selection

• Highlight and comment on the sources of supplier's information

• State and describe and/or calculate both qualitative and quantitative processes of supplier Evaluation (i.e. Pre- and Post - selection evaluation)

3.0 MAIN CONTENT

3.1 Issues Involved in Sourcing Function

D. Dobler and D.N. Burt (1996) argued that buyers must take six important supplier-oriented actions in order to satisfy the performance of sourcing function in purchasing. It is argued that the buyers must:

1) Develop and maintain a viable supplier base or source
2) Address the appropriate strategic and tactical issues
3) Ensure that potential suppliers are carefully evaluated and they have the potential to be satisfactory partners.
4) Decide whether to use competitive bidding or negotiation as the basis of source selection
5) Select the appropriate source
6) Manage the selected supplier to ensure timely delivery of the required quality at the right price.

Peter Baily et al (1996) further argued that for its proper performance, sourcing requires supply market research. This is a normal part of buying work, undertaken informally by buyers when they talk to representatives or salesmen, visit exhibitions, read trade journals, and investigates the market before placing orders. It may additionally be undertaken as staff or support function to buyers by full-time purchasing research staff within a purchasing services section of company. The objectives for this supply market research include:

1) The identification of the set of actual and potential sources, which constitute a supply.

2) Investigation of the suppliers' capabilities,

3) Examination of market trend and prospects of long-term supply; and

4) The general keeping of the buyer's ears to the ground.

Figure 4-1 outlines the procedure normally involved in selecting suppliers. The model suggests that:

1) the buyer, once receipt of a purchase requisition, first checks whether the organization is currently committed to the particular supplier for the supply of such items and, if not;

2) whether an existing source might satisfy the requirement

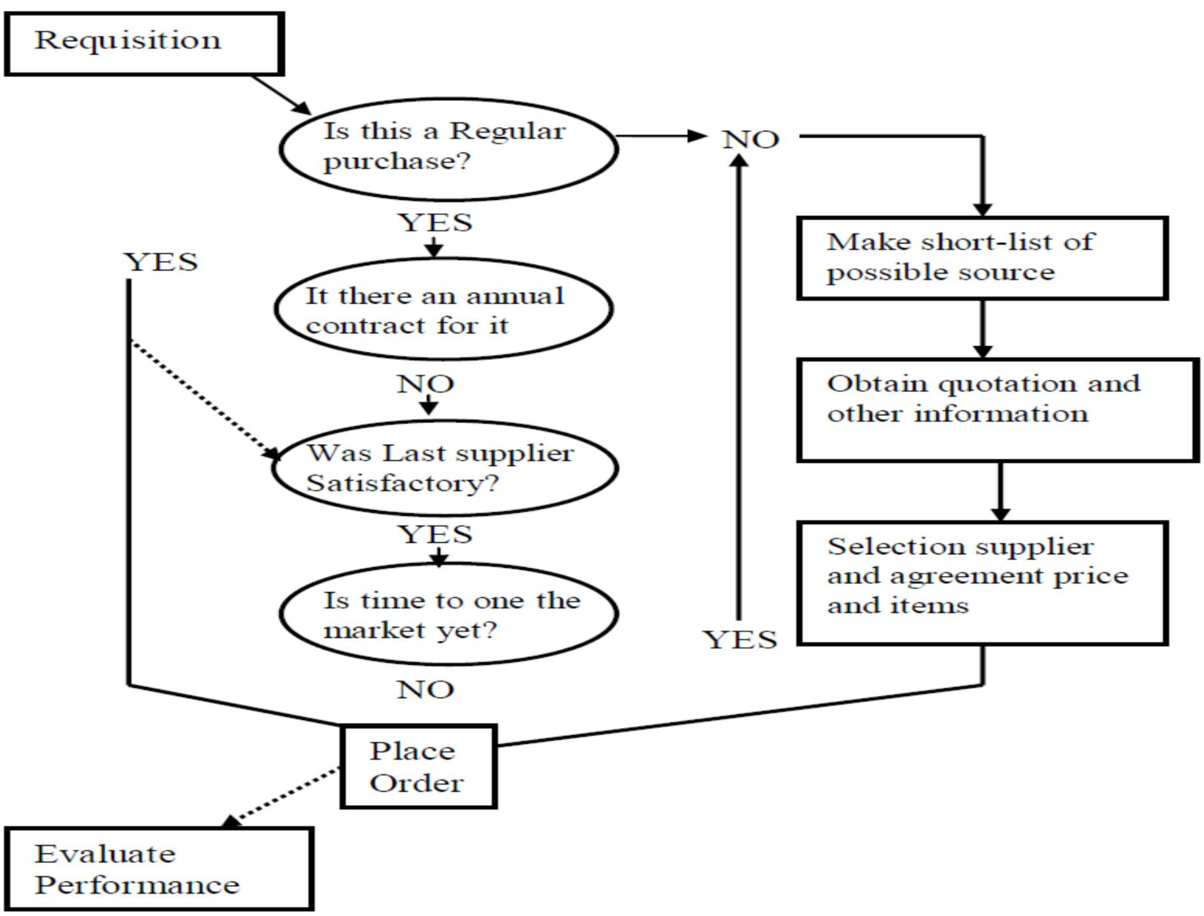

Figure 4.1: Outline of procedures for selecting suppliers. The broken line indicates steps taken after orders have been placed.

3) Repeat ordering with an existing source would be normal unless for some reasons necessitating a review of such an arrangement. Such reasons might include:

a) recent price increases,

b) recent extensions in supplier supply lead-time

c) failing to meet specifications,

d) decline in vendor rate performance.

3.2 Factors in Supplier's Selection

The primary concern of the purchasing department is to successfully identify and secure the services of those suppliers that will help realise both objectives of the purchasing department and the overall company's objectives. Hence when selecting a supplier, the buyer is attempting to find a company or companies which will meet its needs. Those needs usually include reliability in quality and service terms, while the relevant pricing is competitive. The benefit of accurate supplier selection can therefore include such factors as reliability, quality, delivery, performance, reputation and continuity of supplies. Great care must be taken over the selection of every supplier: short cuts in this area will lead to inefficiency and loss of profitability in the long run. The supplier's selection decision is based on the following factors, all of which must be carefully researched and analysed by the purchasing department.

1) Assurance of Supply

Reliability of supply is becoming increasingly important to both buyers and suppliers. Hence, supplier's who suffer recurring shortages themselves must be used with great care, regardless of their other desirable capabilities. Suppliers who have assured, long-term source for their raw materials and component parts should be favoured and developed.

2) Size of Supplier

Some purchasing authorities theorize that the size of an order should correlate with the size of supplier – receiving the order.

3) The Number of Suppliers

The number of suppliers to be selected for a particular line of products or group of items is another important factor that must be given careful consideration. Selecting one supplier for a particular product, no matter how reliable the source could be proves unwise in the long run. Similarly, selecting too many suppliers for an individual material may result in the buyer's inability to fully tap the resources of these suppliers.

4) Developing New Source of Supply

In some cases a buyer is not able to select but must create a satisfactory supplier. If existing suppliers cannot satisfy a company's needs, a logical alternative is to create a supplier that can. Encouragement of this nature may involve setting-up or equipping such local producer financially and materially up to the level expected by the buyer.

5) Conflict of Interest

In selecting suppliers, buyers must be aware of conflicts of interest. A conflict of interest exists when buyers must divide their loyalty between the firm, which employs them, and another firm.

6) The Policy of the Buying Firm

A company's policy may for example favour reciprocity, single or multiple sourcing. In purchasing, suppliers who patronize the buying company are given priority when it comes to selection of suppliers. Some companies makes it a matter of policy to reward indirectly, those customers that buy from them regularly and are found capable of performing certain jobs for the company.

7) Ethical Consideration

Buyers should keep themselves as free as is humanly possible from unethical influences in their choices of suppliers. Gift from suppliers which are intended to influence buying decisions have no place in a professional purchasing department. In most cases, commercial bribery is a criminal offense.

8) Dishonest Suppliers.

Dishonest sellers exist in the industrial world just as they do in the consumer world. Purchasing personnel should be wary of dishonest suppliers and endeavour to avoid them. Their aim is to swindle the buying company.

9) Local Sources It is always desirable to patronize suppliers located within the buyers' immediate environment. This will help to promote good relationship between the local community and the company. It is only when materials in question are not available at the expected quantum that buying from distant source can be justified.

10) Government Policy

For the purpose of controlling foreign exchanges, government may for example, impose restrictions on importations of certain goods thereby preventing the sourcing of the goods in foreign supply markets. In such cases, the buyer's range of sourcing is limited to the local market.

11) Others Other factors, which for obvious reasons may be taken into account in supplier's selection, can be listed as follows:

1) Relative price of goods and services supplied by the supplier, compared with his competitors.

2) Delivery dates, methods and cost delivery. In many instances, the delivery element is more important than price, provided the prices are within the boundaries of the main competitors.

3) Supplier's reputation, especially within the industry or trade.

4) History of labour relations at the supplier's end.

5) Financial solvency of the suppliers;

6) Legal constraint, e.g. patent law.

3.2.1 Attributes of a Good Supplier

Peter Baily et al (1996), suggested a number of attributes which might be regarded as desirable for a typical relationship. These include:

1) Delivery on time

2) Provide consistent quality

3) Gives a good price

4) Has a stable background

5) Provides a good service backup

6) Provides a good stock service

7) Does what he/she says they will do

8) Provides technical advice

9) Keeps the buyer informed on progress

3.3 Sources of Supplier Information

The task of obtaining information about sources of supply is a continuous exercise in purchasing function. Sources of information about suppliers are plentiful. The following sources should prove helpful to a buyer in preparing a list of potential suppliers.

1) Supplier Purchasing Information File

File on past and existing suppliers are already source of information where the purchasing department can always contact to obtain whatever information they may require about suppliers. Such supplier information files commonly contain the name of each supplier, a list of materials he can supply, his delivery history, his quality rejection record, his overall desirability as a supplier, and general information concerning his plant and management.

2) Supplier Catalogues

Catalogues are a commonly used source of supplier information. Many purchasing departments maintain a catalogue room, where users can examine the catalogues to try locate the materials they need. Some large companies keep a special library file containing catalogues, price lists and other literature from potential suppliers.

3) Trade Journal

Trade journals are another excellent source for obtaining information about possible suppliers. Advertisements in trade journals are often a buyer's first contact with vendors and their products. In the field of purchasing, the magazines, purchasing and purchasing world are perhaps best known and widely read trade journals.

4) The "Yellow Pages"

Another commonly known directory is the classified 'yellow page' section of telephone directories. Though, this source of information is frequently of limited value to many industrials buyers, yellow pages do, however, have the virtue of being well indexed. Also they can serve as a useful starting point if other sources have proved fruitless, and local sources are desired.

5) The Internet

Understanding the versatility of information technology through the nerves of computing is perhaps a prerequisite for appreciating the enormity of advantages of using the internet for business and other purposes. From the inception of the internet evolution (which originated as APPANET, a United States Government Research Project), the net has grown to become an information super highway, linking many millions of computer systems and digital machines as well as millions of users around the world. A great majority of these linkages and users are primarily hooked-up for economic (business) purposes.

The internet has become an electronic market place such that a tremendous amount of activities (e.g. retail activities, selling digital delivery of services, buying or procurement, etc) takes place as companies now set-up their customer-service functions on the internet.
The beauty of the internet is that it can make it easier for companies in developing countries to do business globally. Companies can now set-up internet facilities and immediately have access to a billion of people and other business globally as a market. This opens up a wave of information opportunities to buyers world-wide to expand their knowledge of new products, new vendors, and new ideas.

6) Sales Personnel

Sales personnel is an excellent source of information for possible sources of supply. Not only are they usually well informed about the capabilities and features of their owner products. But they are also familiar with similar and competitive products as well. By the very nature of their specialized knowledge, sales people can often suggest new applications for their products, which will eliminate the search for new suppliers.

7) Trade Exhibit

Regional and national trade shows are still another way in which buyers learn about possible source of supply. The use of exhibition as a means of sales presentation is greatly increasing. They provide an excellent opportunity for buyers to see various new products and modifications of old products. They also offer buyers an opportunity to compare similar products from different manufacturers.

8) Company Personnel

Personnel in other departments within a company are often knowledgeable about the source of materials relating to their specialisation. Through their association in professional organisations, civic associations or social groups, these employees often learn about outstanding suppliers.

9) Other Purchasing Departments Purchasing departments in other companies are most helpful sources of information concerning supplier with whom they deal.

10) Organisations Promoting Trade Information on suppliers can readily be obtained from trade register and directories compiled by the umbrella bodies of trade associations such as the manufacturers Association of Nigeria (MAN), Chambers of commerce, etc.
Such directories contain names of manufacturers, their addresses and branches as well as their various products. Similarly, embassies and commercial attaches are usually keen to help buyers to find sources of supply in the territories they represent.

3.4 Supplier Evaluation

In purchasing, suppliers are regarded as partners in progress to the buyer's organisation. This is because supplier's performance is capable of influencing the organisation's success. For this reason, selection of suppliers as well as evaluation of their performance is an important responsibility of not only the purchasing department, but the entire buying company. After a major supplier has been selected and they-supplier relationship has begun to develop, it is important monitor and assess the supplier's overall performance. The purpose is to enhance the relationship and thereby control performance. The evaluation of actual and potential source is a continuing process in purchasing departments. Actual source with which one is dealing regularly can be evaluated largely on their track record: on the actual experience of working with them. This is known as vendor rating. Vendor rating is intended to evaluate the performance of supplier in terms of prices, quality, delivery and service. The type of evaluation required to determine suppliers' capability however varies with:

1) the nature,

2) complexity; and

3) the total value for the purchase to be made.

3.4.1 Pre-Selection Evaluation

This type of evaluation is aimed at obtaining information about the prospective supplier to determine his suitability to meet the buyer's requirement if selected. Potential sources can be evaluated only by judgment of their capabilities. Pre-selection evaluation may generally involve the following considerations:

1) Supplier's Registration Form

As a pre-requisite, most suppliers seeking to do business with another organisation are expected to pass through a formality by completing a registration form made available by the buying company.

The type of information usually required from such suppliers are details like name of company, address, type of business or products, financial capabilities, and a host of other information that will enable the buying company determine the suitability or otherwise of the potential source.

2) Product Testing

In some cases, special request is made for the samples of the product advertised or intended to be supplied for preliminary testing. If these products are used for certain period by the company and are found suitable for the purpose for which they are needed, the supplier can be considered.

3) Plant Visits

On-the-spot surveys of facilities and personnel by the technical and commercial representatives of the purchaser are often carried out to evaluate potential suppliers-although sometimes it may possible to eliminate this on the basis of a supplier's reputation, as obtained from word – of – mouth and published information.

4) Financial Condition

This is an important factor in evaluating capability of a potential supplier. This type of evaluation places more emphasis on the solvency of the supplier over and above other requirements. Financially strong firms are usually, although not always, managerially strong also, hence they generally make good suppliers. Analysis of balance sheets and profit and loss statements can be of immense benefit in the evaluation of vendor's financial condition.

5) Management

It becomes necessary at times to have insight of the potential supplier's management quality of his organisation, in terms of personnel, plant maintenance, staff wages and welfare package. This is because, if an organisation is well managed, cases like high labour turnover rate, industrial unrest which are capable of affecting supplier's product quality, delivery performance and service will be completely eliminated or reduced to the barest minimum.

3.4.2 Post-Selection Evaluation of Supplier

When suppliers are finally selected and have been allowed to perform over a period, it is necessary that their performances are evaluated for the purpose of determining their respective capability in terms of quality, price, delivery and service.

Donald W. Dobler and David N. Burt (1996) reviewed three types of evaluation plans that were investigated by the National Association of Purchasing Management. These include:

1) Categorical Plan

Under this plan, personnel from various departments of the buying company maintain informal evaluation records. The individuals involved traditionally include personnel from purchasing, engineering, quality, accounting, and receiving. For each major supplier, each evaluator prepares a list of performance factors, which each supplier is evaluated against. After the factors are weighted for relative importance, each supplier is then assigned an overall group evaluation, usually expressed in simple categorical terms, such as “preferred”, “adequate”, “unsatisfactory”. This simple qualitative plan is easy to administer and has been reported by many firms to be very effective. The categorisation sample of overall scores is shown in Table 4.1

	Performance Factor	Preferred	Adequate	Unsatisfactory
1	Quality	18-20	10-17	0-9
2	Delivery	16-20	8-15	0-7
3	Commercial	18-20	12-6	0-11
4	Technology	18-20	10-16	0-8
5	Management	16-20	10-14	0-8
	Target total	86-100	50-85	0.49

Table 4.1 Supplier performance and ranking system categorisation of overall scores

To achieve Preferred Supplier status, scores in all categories must fall within the 'Satisfactory' and Adequate' ranges. Any 'Unsatisfactory' scores will be followed up and reviewed and, if not improved within acceptable timescales, may lead to deselection.

A guide to classification based on scores is given with target scores for preferred suppliers with whom the company intends to place long-term business identified.

2) The Weighted Point Plan

This plan involves giving weight to every performance factor to be evaluated and oftentimes, various aspects of quality, service, delivery and price are given weights.

For example in one circumstance, quality might be weighted 30 percent, service 25, and price 40 percent. In another, quality could be raised to 45 percent, and price reduced to 20 percent.

The weight selected in any specific situation represents the buyer's judgments about the relative importance of each factor.

After performance factors have been selected and weighted, a specific procedure performance on each factor must be expressed in qualitative terms. To determine a supplier's overall rating, each factor weight is multiplied by the supplier's corresponding performance number; the results (for each factor) are then totalled to get the supplier's final rating for the time period in question.

ILLUSTRATION 1 The following hypothetical case illustrates the procedure. Assume that the purchasing department of Koriope & Sons Ltd. has decided to weight and measure the three basic performance factors as follows:

Weight	Factors	Measurement formula
45%	Quality performance=	100%-percentage of rejects
25%	Service performance=	100%- 5% for each failure
20%	Price performance =	Lowest Price offered
		Price actually paid

Assume further that suppliers anytime performed as follows during the past month: Seven percent of his items were rejected for quality reason; Four unsatisfactory split shipments were received; and vendor Ayim's price was 110 per unit. Compare with lowest offer of N80 per unit. The workings below summarize the total performance evaluation for supplier Ayim

Factor	Weight	Actual Performance
Quality	45	7% rejects
Service	25	4 failures
Price	20	₦ 100

Performance Evaluation

For quality	=	45 x (100% - 7%)
		45 x (1.00-0.007) = 41.90
For service	=	25 x (100% - (5% x 4)
	=	25 x (1.00- .05 x 4)
	=	25x0.8 = 20
For price	=	$20 \times \frac{N80}{N100}$
	=	2x 0.8 = 16

Overall Evaluation: 41.90 +16 = 77.9%

This example is not the only method available, nor has it been so comprehensively dealt with. Some of the more sophisticated applications can be very complicated. The above can however be used to evaluate any number of different suppliers whose performance is particularly important during a given operating period. Example 2 further illustrates this point.

ILLUSTRATION 2 Arijenimondaru Co. Ltd. divides the purchase of Abacha television sets between Kalu and Naaba. He wishes to compare their performance with regard to quality and delivery for two years, 2003 and 2004. The year 2003 is taken as the base year.

SOLUTION

• Quality rating

Year	Vendor	Intake	Rejects	%Reject	Index
2005	Kalu	2,900	75	2.6	100
2005	Naaba	1,850	45	2.4	100
2006	Kalu	3,400	83	2.4	92
2006	Naaba	2,350	47	2.0	83

$$\text{Index} = \text{For Kalu :- } (2006) = \frac{2.4}{2.6} \times 100 = 92$$

$$\text{For Naaba :- } (2006) = \frac{2.0}{2.4} \times 100 = 83$$

Remarks: In 2006 Kalu recorded an 8% defective materials supplied rate (i.e. percentage rejects) while Naaba recorded suffered a 17% reject rate of total materials supplied in the given year.

• **Delivery rating**

In a similar way to what was done in respect of quality performance, it is possible to keep delivery records, showing shortage, early or late arrivals, or any variation on the contracted delivery programme. These facts can be used to produce a delivery rating, which may be applied either separately or in conjunction with quality rating. This makes the whole operation more complicated, and is normally attempted only where delivery is of vital importance and where the quality scheme is already well established.

Year	Vendor	Delivery	Total Day Late	Average Day Late	Index
2005	Kalu	7	49	7	100
2005	Naaba	15	75	5	100
2006	Kalu	10	60	6	85.7
2006	Naaba	8	24	3	60

Index: for Kalu:- (2006) $= \frac{6}{7} \times 100 = 85.7$

For Naaba: - (2006) $= \frac{3}{5} \times 100 = 60$

Remark: In 2006 the performance of Kalu showed a 14.3% delivery failure as against Naaba's 40% delivery failure rate in the give year. Overall rating: Assuming that quality and delivery are weighted 45% and 15% respectively; the overall rating would be:

Factory	Supplier Kalu	Naaba
Delivery	85.7	60
Quality	92	83

$$\text{Overall index for Kalu} = \frac{92\ (45) + 85.7\ (15)}{100}$$

$$= \frac{4140 + 1285.5}{100}$$

$$= \frac{5425.5}{100} = 54.3\%$$

$$\text{Overall index for Naaba} = \frac{83\ (45) + 60\ (15)}{100}$$

$$= \frac{3735 + 900}{100}$$

$$= \frac{4635}{100} = 46.4\%$$

Remarks: Vendor Kalu demonstrated superior performance rating in the year in question.

► The Cost – Ration Plan

This involves the use of management tools or techniques such as standard cost, average cost, weighted average cost, etc. to determine or evaluate the performance of each supplier. This type of evaluation is based mainly on the price and cost of rejects or non-performance by the supplier. All the three of the evaluation plans discussed – categorical, weighted-point, and cost-ration – involve varying degree of subjectivity and guesswork.

The Quantitative (weight-point and cost-ration) remarkably are deficient in the light of: 1) Wrong impression it gives about its scientific accuracy while in effect, they are not more accurate than the assumptions on which the quantitative data are based. 2) The high cost of collecting the data on which the rating are based; 3) Supplier performance is often affected by circumstance outside the control of the vendor. In the final analysis, therefore, supplier evaluation must represent combined appraisal of facts, quantitative computations, and value judgments. It simply cannot be achieved effectively by mechanical formula alone.

SELF ASSESSMENT EXERCISE

What objectives should supply market research seek to achieve?

4.0 CONCLUSION

An important function of purchasing is the identification of suitable sources of supply. The systematic investigation and comparison of sources, the evaluation and monitoring of performance of supply sources and the development of appropriate procedures with supplier are therefore of importance. In purchasing, suppliers are regarded as partners-in-progress to the buyer’s organisation. This is because supplier’s performance is capable of influencing the organisation’s success. For this reason, selection of supplier as well as evaluating their performance is an important responsibility of not only the purchasing department, but the entire buying company.

5.0 SUMMARY

Selection and management of the right supplier is the key to obtaining the desired level of quality, on the time and at the right price to meet up with the company’s purchasing objectives and policies.

The management of the supply may however require advance planning, forethought and the ability to make some decisions. Sourcing in purchasing has not only gone beyond simply picking a supplier for each order in isolation but also as follows:

• It involves continuing relationships, both with preferred source which are actually supplying goods and services, and with potential source which may have been passed over for the present but are still in the running.

• It involves decisions about how to allocate the available business, and what terms to do business on.

6.0 TUTOR-MARKED ASSIGNMENT

What are the Important Supplier – oriented actions that buyers must take in order to satisfy the performance of sourcing function in purchasing?

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Contents

1.0 INTRODUCTION

Price is important both to the seller and the buyer. It is regarded as one of the elements in the marketing mix. As it is used in purchasing, price is the mechanism for measuring the value of good and services in monetary terms. 1) This definition is consistent with one of the main objectives of purchasing which is to obtain value for money on all occasions. 2) The definition also enables us to appreciate the role of price in the purchasing and supply functions. For the purchaser however, price is just one of the elements taken into account in making a purchasing decision. Non-price factors, which may be important, include; delivery, service, reliability, product quality, terms of payment, location and many more. Value for money therefore depends not only on price, but on what is provided for the price.

2.0 OBJECTIVES

At the end of studying this unit, you should be able to:

• list and explain the importance of obtaining materials at the right price

• state clearly the role of price in purchasing

• describe how buyers obtain prices

• highlight and discuss the factors influencing price setting

• enumerate the uses and importance of discount in the purchasing function

• discuss the issues involved in procurement timing policies

3.0 MAIN CONTENT

3.1 Importance of Obtaining Materials at the Right Price

Obtaining materials at the right price is important; it literally can mean the difference between a firm's success or failure. With the traditional approach to purchasing, it is easy for the importance of pricing to be over-looked. For instance, in traditional purchasing theory: (1) It is frequently stated that price may be low or high, what matters most is service and delivery reliability. Or rather, (2) Price is not the major consideration in making purchases; rather, the main concern is the continuous flow of materials at all cost. This traditional attitude is loaded with massive implications, the most obvious of which are: 1) The danger of collusion to buy goods and services at high or inflated price; 2) The danger of buyer developing inertia or unwillingness to investigate new and cheaper sources of supply; 3) The possibility that the cost-saving function of purchasing may be totally ignored or abdicated. These implications are all together very detrimental to the corporate financial position.

Purchasing should ideally aim for the right price; this is a price, which gives the best value to the organisation, taking quality, delivery and relative urgency into account. This may not always be the lowest price available, but the one, which represents the best value over a period of time. Professional buyers commonly interpret the right price as one that is fair and reasonable to both the buyer and seller.

3.2 The Role of Price in Purchasing

As a monetary phenomenon, Fajemilua (1997: p.78) listed the following five roles price plays in the purchasing cycle:

1) It is the basic unit for measuring and assessing other factors (such as quantity and so on) which influence the purchasing decision process;

2) It provides the yardstick for comparing supplier's quotations and assessing the relative value of their service;

3) It is the basis for costing store issues; evaluating stock balances damages for losses in a storehouses

4) Price is used for costing, purchasing and supply operations with a view to evaluating performance.

5) It provides the yardstick for the application of most stock-control techniques.

3.3 How Buyers Obtain Price

The methods of communicating price will vary according to: 1) The nature and complexity of the purchase; and 2) The manner in which it is being dealt with, that is, either by an individual consumer or an industrial buyer. Two broad categories of methods are however discussed in this text. And these are:

3.3.1 General Methods: Some of the general methods used in price determinations are as follows:

1) **Haggling:** This is the traditional method and it is used mainly in making purchases for private consumptions. The method calls for bargaining and usually, the selling price is between the range of prices, which will satisfy both the seller and the buyer.

2) **Auctioning:** Here, an auctioneer puts an article on sale and calls for bids. The prospective buyers then make their offers. In the end, the article goes to the highest bidder. The selling price of the article will therefore depend on the keenness of the buyers to buy.

3) **Fixed Pricing:** Many sellers may not want their customers to haggles on price. Rather, they prefer to fix prices at which they
think they can sell their goods. This is the method used for the purchase of goods in most supermarkets and retail stores. However, the seller cannot fix price and at the same time determine the quantity to be sold.

4) **Demand and Supply Approach:** According to the micro-economic theory, the buyer on the one hand will always buy more at a lower price than at a higher price and suppliers on the other hand will always supply more at a higher price than at a lower price given that all things are equal. The equilibrium price of a commodity will be fixed at the point where the forces of demand equate the forces of supply.

3.3.2 The Industrial Buyer's Approach

The professional buyers determine the purchase price of goods and services using a number of methods. The more common methods include:

1) The Use of Published Price Lists: Price of many industrial goods and services are frequently published in newspapers, price catalogues and trade journals.

An experienced buyer does his best to keep abreast of published price lists or gazette price and makes use of such price information in the procurement of goods and services for his organization.

2) Contact with Salesmen: The professional buyer is placed in a unique position to meet and interact with salesmen from different supplying firms and organisations. Through this discussion with such salesmen, the buyer becomes conversant with current prices of industrial goods and services.

3) Quotations: The commonest method used to determine purchasing prices is by inviting quotations from the prospective suppliers. The quotation obtained are compared and analysed to determine the most advantageous offer.

4) Tendering: This can be an open selection depending on the type of purchase or policy of a particular organisation. Under the open tendering system, as many suppliers as possible are usually invited through public advertisement to tender for the required goods and services. The selective tendering system on the other hand does not permit open competition. Only a few suppliers specialising in a particular field are selected and invited to submit tenders in their area of specialisation. The tenders submitted are collated and evaluated for the purpose of determining award prices. The tendering system is very common with government establishments. Such departments usually set up committee known as Tenders Boards for the purpose of opening tenders, evaluation and fixing prices.

5) Negotiation: In this case, it must be noted that price is not the only subject covered by negotiations. Even though price is a major consideration in all negotiations; other factors such as quality, quantity, delivery schedule and service are negotiable. Negotiation is a complex process which requires some strategies and tactics for its success.

3.3.2 Factors Influencing Price Setting

Many factors influence price and pricing strategy and operate at the environmental, organisational and strategic levels of any business firm. Some of those factors as identified by Needle (1992, pp. 230-232) are dealt with here under the following headings;

1) Cost

A useful way to consider costs is according to whether the sum is fixed or variable. Fixed cost is the sum total of costs that do not change when organisational output increases or decreases. Variable cost is the total of those costs, which change when the organisational output change i.e. expenses for raw materials. A business firm wishing to make a profit must use the cost of making a product or providing a service as an important base point in setting its prices.

2) Consumer Behaviour

The price of a product may well be related to what a consumer can afford and what he is prepared to pay. These in turn are related.

1) Income levels;

2) The consumer's perceptions of quality and value for money; and

3) The consumer's budget for a particular purchase.

3) Economic Factors

Price is related to the economy in a number of different ways, all of which have a potential impact on an organisation's pricing policy. The affluence of consumers will have an obvious influence on their level of budgeting, and regional variations in consumers' affluence may produce differential demand, especially for certain luxury items. The role of the state in managing the economy may affect both demand and prices. During the periods of high inflation, the government may well introduce measures to control prices.

4) Competition

Many business firms price their products by reference to an existing market, basing their price around that offered by competitors for products of similar features and quality. When the prevailing market condition is keenly competitive, the demand for a business firm's product is perfectly elastic that is, the firm can sell its products only at or near the market price.

5) Management Goals

The price of goods is often related to the extent to which management wishes to optimize profit. The desire of a group of managers for a larger market share for their products may result in a low price strategy to build up demand.

6) Organisational Size

The size of an organization may give it market power and the ability to manipulate market price. This is especially true of few sellers or Oligopolies (*oligos* means few in Greek). A major fast food chain such as Mr. Biggs is able, because of its purchasing power and stock turnover, to insist on large price discounts from its suppliers.

3.5 The Use and Importance of Discounts in Procurement

Industrial purchases are usually subject to cash, trade, and quality discounts. Procurement agents and buyers must be thoroughly acquainted with these discounts as they apply to the purchases that they are making – and with the legal aspects of same. Technically; A discount is a percentage variation to the nominal price. It involves the offer of reductions (differentials) from a base price and must also be considered when price policy is being determined. By using a system of discounts, sellers can modify the prices without having to set new list prices.

3.5.1 Types of Discounts

The criteria for supplier discounts are many and it may be an exercise in futility to attempt to identify and describe all of them. The following are however the most usual forms:

1) Trade Discount

The trade (also sometimes called functional) discounts are price reductions given to various classes of buyers and distributors to compensate them for performing certain marketing functions for the original seller (the manufacturer) of the product. Ordinarily the amount of a buyer's discount depends upon whether he is a wholesaler, an industrial purchaser, or a retailer. Discounts are lowest for the retailer and highest for the wholesaler.

2) Quantity Discounts

The quantity discount is offered on the basis of the amount of the commodity purchased. These are price reductions given to a buyer for purchasing increasingly larger quantities of materials. Quantity discounts may be cumulative or non cumulative these are explained as follows: **Cumulative quantity discounts** are based upon purchases made from a single source during a prescribed period of time, such as six months. **Non-cumulative discounts,** which are more common, apply only to a single purchase.

Quantity discounts, whatever their form, offer definite advantages. From the manufacturer's viewpoint, the following advantages are notable:

1) They encourage purchasers to buy more frequently from a single vendor,

2) They stimulate larger order, and

3) They result in increased production units, since voluminous production is made possible by the increased demand.

From the buyer's viewpoint, quantity discounts are advantageous because:

1) He is able to buy at lower net prices.

2) The ultimate consumer and the industrials consumers also benefit from the decreased price level those results.

Quantity discount also have disadvantages.

1) Producer: overestimating the savings that may result from obtaining a large order, may allow too much discount.

2) Moreover: small-scale buyers may resent the fact that lower net prices are offered to large-scale purchasers.

3) Cash discounts: A cash discount is offered for payment of bills in advance of the due date. Most business transactions from manufacturer to different classes of buyers are conducted on credit terms. The length of time allowed for payment varies considerably and payment in practice is often delayed beyond the duration of the officially stated credit terms.

4) Seasonal discounts: Based on the seasonal nature of some products (primarily consumer products), their producers commonly offer discounts for purchases made in the off-season. A seasonal discount is thus offered to stimulate the purchase of seasonal goods during "off-peak" period.

The **objectives are** to;

(a) Move the seasonal produce of the seller out of warehouse and,

(b) To maintain a move balanced production throughout the year in order to reduce overhead costs

5) Geographical differentials: These are price variations offered in relation to distance from supply base e.g. new car delivery.

6) Special discounts: Many discounts fall within this category. They are special discounts made available by vendors or suppliers only by exceptional and special or temporary circumstances.

3.5.2 Use of Discounts

From the foregoing discussion, it may be summarized that discounts are offered for four main reasons: (1) To obtain prompt payment

(2) To change prices without reprinting price lists.

(3) To give special terms to special classes of customer

(4) To induce customers to buy large quantities.

3.6 Procurement Timing Policies and Inventory Management

One of the primary roles of purchasing is to ensure adequate supply of materials and components of acceptable quality in the most cost-effective manner. The procurement function has since realised the existence of the numerous problems affecting certain commodities and the characteristic of such markets. Purchasing therefore, faced this situation must formulate fundamental policy decisions on either:

- Buying for the purpose meeting immediate needs;
- Buying according to the dictate of the markets.

1) Buying for Immediate Requirements

This type of policy stipulates that materials are brought into the organisation only when the need arises. This action implies that more emphasis is placed on inventory levels rather than on prices of materials, since commodities are subject to price fluctuations or forces of demand and supply. Buyers take the advantage of lower prices to stock goods in excess of their immediate requirements. This policy option therefore, requires that, purchases can only be made regardless of whatever the selling prices are, at the time of purchase.

2) Buying according to the dictates of the market

This policy option takes into consideration the market situation affecting prices of goods such as seasonal fluctuation, or actions of the market. Buyers that select this option may have chosen between the following market activities:

(a) Hand-to-mouth buying

(b) Speculative buying

(c) Forward buying.

(a) Hand-to-Mouth Buying

This is the practice whereby buyers engage in buying to satisfy immediate requirement especially when prices are considered to be high. It is a policy frequently used in difficult trading periods, or when a company wants to conserve its financial resources. The principle is to buy exact need and save money, rather than buying in excess of immediate needs when prices are high.

(b) Speculative Buying

This practice involves buying in anticipation of future rise in prices. If the price of certain commodity is known to be capable of unexpected fluctuation or the availability of such commodity is not certain, speculative purchase of such commodity may be considered prudent. This type of buying therefore refers to buying in excess of immediate requirements in order to take the advantage of lower prices or unforeseen scarcity.

(c) Forward Buying.

This is the practice of buying materials in excess of current requirement, but not beyond the actual foreseeable requirements. The objective of forward buying policy is to take care of well-defined production requirement, especially in a situation where materials scarcity or price increase is foreseeable in the nearest future. Some of the advantages of forward buying are: 1) It enables the buyer to know the production cost of an item before they embark on the production activities; 2) It also reduces the risk of inadequate delivery in a period of materials shortage or scarcity.

SELF ASSESSMENT EXERCISE

State the general methods used in price determination.

4.0 CONCLUSION

Obtaining materials at the right price is important. It literally can mean the difference between a firm's success or failure. This is a major responsibility of the purchasing group. Many factors influence what is a right price; even though it is hardly possible to comprehensively discuss this. But this clarification must be made because of the erroneous idea that the price level is of little importance in industrial buying decision-making process. With the traditional approach to purchasing, it is easy for the importance of price to be over-looked.

Purchasing should ideally aim for the right price; this is a price which gives the best value to the organisation, taking quality, delivery and relative urgency into account. This may not always be the lowest price available, but the one, which represents the best value over a period of time. Professional buyers commonly interpret the right price as one that is fair and reasonable to both the buyer and seller. Unfortunately, no single set of pricing principles or criteria exist for calculating precisely what constitutes a fair and reasonable price. The right price from one vendor is not necessarily the right price from all other vendors, at either the same or at different points in time. To determine the right price, for any specific purpose, a number of constantly changing variables and relationships must be evaluated.

5.0 SUMMARY

Price is important both to the seller and the buyer, but it is regarded as only one of the elements in the marketing mix. As it is used in purchasing, price is the mechanism for measuring the value of goods and services in monetary terms. As stated earlier, the right price is not always the lowest price available. The purchasing group may have occasions to suspect a low quotation particularly where: (1) It may entail reduction in quality and service levels or; (2) Where it may lead to right final costs in the end. Whether a particular price is to be considered the right one or not depends on the situation. There are times when a low quotation may result from a deliberate action of a particular supplier. The buyer must take advantages of such pricing opportunities after satisfying himself that the low prices are not designed to reduce quality and service levels. On the other hand, market condition may justify buying at a high price in order: (1) to avoid buying at anticipated higher prices later. (2) similarly, such a high price may reflect the superior quality and services level of the vendor, which cannot be compromised. It therefore follows from the above that the buyer must be thoroughly familiar with market gimmicks.

6.0 TUTOR-MARKED ASSIGNMENT

Summarise the reasons for offering discounts in purchasing.

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UNIT 6 TERMS OF PAYMENT FOR GOODS----------------------------63

Content

1.0 INTRODUCTION

The elements of price included in the quotation of a tenderer depend on the nature of the goods to be supplied and the allied services to be performed, location of the supplier, location of the user, terms of delivery and regulations about taxes, duties, etc. of the seller's country and the buyer's country. In case of indigenous goods, the main elements of price are raw material price, production cost, overhead, packing & forwarding charges, margin of profit, transit insurance, excise duty and other taxes and duties as applicable.

In case of imported goods, in addition to similar elements of price as above (other than excise duty and taxes), there may be elements of custom duty, import duty, landing and clearing charges and commission to Indian agents. Further, depending on the nature of the goods (whether domestic or imported), there may be cost elements towards installation & commissioning, operator's training etc.

It is, therefore, necessary that, to enable the tenderers to frame their quotations properly in a meaningful manner, the tender documents should clearly specify the desired terms of delivery and, also the duties and responsibilities to be performed by the supplier in addition to supply of goods.

Where the price has several components like price of the goods, costs for installation & commission, operators' training etc. the tenderers should be asked to furnish the cost break-up indicating the applicable prices for each such component (as specified and desired in the tender enquiry document) along with the overall price. This unit discusses the terms of payment for all categories of purchased goods.

1.0 OBJECTIVE

At the end of studying this unit, you should be able to;

1) Discuss the issues involved in the payment terms for domestic goods
2) Explain the related issues of terms of payment for imported goods in different situations

3.0 TERMS OF PAYMENT FOR GOODS

3.1 Terms of Payment for Domestic Goods

Where the terms of delivery is FOR Despatching Station, the payment terms, depending on the value and nature of the goods, mode of transportation etc may be – 60% to 90% on proof of despatch and other related documents and balance on receipt at site and acceptance by the consignee. Where the terms of delivery is CIP destination/delivery at site/FOR destination, usual payment term is 100% on receipt and acceptance of goods by the consignee and on production of all required documents by the supplier.

Where goods to be supplied also need installation and commissioning by the supplier, the payment terms are generally as under:

i) For a contract with terms of delivery as FOR despatching station – 60% on proof of despatch along with other specified documents, 30% on receipt of the goods at site by the consignee and balance 10% on successful installation and commissioning and acceptance by the consignee.

ii) For a contract with terms of delivery as CIP destination/Delivery at site/FOR destination – 90% on receipt and acceptance of goods by the consignee at destination and on production of all required documents by the supplier and balance 10% on successful installation and commissioning and acceptance by the consignee.

It must however be noted that generally, (especially for goods requiring installation and commissioning at site by the supplier), the desirable terms of delivery are CIP destination or Delivery at site, so that the supplier remains responsible for safe arrival of the ordered goods at the site. Therefore, unless otherwise decided Ex-works or FOR Despatching station terms should be avoided.

3.2 Terms of Payment for Imported Goods

3.2.1 **Cases where Installation, Erection and Commissioning (if applicable) are not the responsibility of the Supplier –** 100 % net FOB/FAS price is to be paid against invoice, shipping documents, inspection certificate (where applicable), manufacturers' test certificate, etc.

3.2.2 **Cases where Installation, Erection and Commissioning are the responsibility of the Supplier –** 80% - 90% net FOB/FAS price will be paid against invoice, inspection certificate (where applicable), shipping documents etc. and balance within 21 - 30 days of successful installation and commissioning at the consignee's premises and acceptance by the consignee.

3.2.3 **Payment of Agency Commission against FOB/FAS Contract –** Entire 100% agency commission is generally paid after all other payments have been made to the supplier in terms of the contract.

3.2.4 Payment of Air Freight Charges

Goods that are required to be air lifted are to be despatched through any of the operating Airlines in Nigeria on a `Charge forward basis'. All air freight charges, which are shown on the relevant consignment note as chargeable to the consignee, are to be paid to airliner in naira term.

3.2.5 Advance Payment to Supplier

Ordinarily, payments for supplies made or services rendered should be released to the supplier only after the supplies have been made or services have been rendered. However, it may become necessary to make advance payments in the following types of cases: -

(i) Advance payment demanded by firms holding maintenance contracts for servicing of Air-conditioners, computers, other costly equipment, etc.

(ii) Advance payment demanded by firms against fabrication contracts, turn-key contracts etc.

Such advance payments should not exceed the following limits:

(i) Thirty per cent of the contract value to private firms;

(ii) Forty per cent of the contract value to a State or Federal Government agency or a Public Sector Undertaking;
(iii) In case of maintenance contract, the amount should not exceed the amount payable for six months under the contract.

In exceptional cases, the Ministries or Departments may, in consultation with their Financial Advisers, relax the ceilings mentioned above. However, while making any such advance payment, adequate safeguards in the form of bank guarantee etc. should be obtained from the supplier. Further, such advance payments should be *generally* interest bearing, suitable percentages for which are to be decided on case to case basis.

3.2.6 Documents for Payment

The documents, which are needed from the supplier for release of payment, are to be clearly specified in the contract. The paying authority is also to verify the documents received from the supplier with corresponding stipulations made in the contract before releasing payment. The important documents, which the supplier is to furnish while claiming payment, are:

a) Original Invoice
b) Packing List
c) Certificate of country of origin of the goods to be given by the seller or a recognized Chamber of Commerce or other agency designated by the local Government for this purpose.
d) Certificate of pre-despatch inspection by purchaser's representative
e) Manufacturer's test certificate
f) Certificate of Insurance
g) Bill of lading/Airway bill/Rail receipt or any other despatch document, issued by a government agency (like the Department of Posts) or an agency duly authorized by the concerned Ministry / Department.
h) Product is new, un-used and also meets the other relevant contractual requirements.

While claiming payment, the supplier is also to certify in the bill that the payment being claimed is strictly in terms of the contract and all the obligations on the part of the supplier for claiming this payment has been fulfilled as required under the contract. There should also be a suitable provision for verification of the authenticity of the person signing the invoice etc. for claiming the payment.

3.2.7 Modes of Payment

3.2.7 (a) Payment to Domestic Suppliers

Payments to domestic suppliers are usually made by cheque/demand draft drawn on a Government treasury or branch of the Central Bank of Nigeria or commercial bank in Nigeria transacting government business. Such payment can also be made to the supplier's bank, if the bills are endorsed in favour of the bank with a pre-receipt embossed on the bills with the words, "Received payment" and both the endorsement and pre-receipt are authenticated by the supplier. In addition, an irrevocable power of attorney is to be granted by the supplier in favour of the bank. In such of those cases where there has been global tendering, in order to have uniform payment clauses, if domestic suppliers, especially against high value contracts for sophisticated equipment/machinery, desire payment through Letter of Credit, the same, depending on the merits of the case may be agreed to.

3.2.7 (b) Payment to Foreign Suppliers

Payment to foreign suppliers are ordinarily made by Letters of Credit (LC) opened by the central bank of Nigeria or any other scheduled/authorized Bank as decided by the purchasing Ministry/Department. While opening the Letters of Credit, the Ministry/Department should follow the provision of Uniform Customs and Practices for Documentary Credit (UCPDC). If Letter of Credit is not opened, payment can also be made to the seller through Direct Bank Transfer for which buyer has to ensure that payment is released only after the receipt of prescribed documents.

3.2.7 (c) Payment by Letter of Credit

Two banks are involved for payment to the supplier by Letter of Credit – purchaser's bank and supplier's bank. The purchaser is to forward the request to its bank in the prescribed format as formulated by central bank of Nigeria, along with all relevant details including authenticated copy of the contract.

Based on the same, the purchaser's bank opens letter of credit on behalf of the purchaser for transacting payment to the supplier through the supplier's bank. Care should be taken to ensure that the payment terms and the documents to be produced for receiving payments through letter of credit are identical with those shown in the contract. Generally, irrevocable letter of credit is opened so that the supplier is fully assured of its payment on fulfilling its obligations in terms of the contract. In case, the delivery date of the contract is extended to take care of delay in supply, for which supplier is responsible, the tenure of the letter of credit is also to be extended, but the expense incurred for such extension (of letter of credit) is to be borne by the supplier.

3.2.7 (d) E - Payment

E - Banking and E - Payments are now used by various banks by adopting Electronic Clearing System (ECS) and Electronic Fund Transfer (EFT) procedure. Payments to suppliers may be made through such mechanism where such facilities are available.

3.2.8 Recovery of Public Money from Supplier's Bill

Sometimes, requests are received from a different Ministry/ Department for withholding some payment of a supplier out of the payment due to it against a contract. Such requests are to be examined by the Ministry/Department (which has received the request) on the merits of the case for further action. It will however, be the responsibility of the Ministry/Department asking for withholding of payment to defend the Government against any legal procedure arising out of such withholding as also for payment of any interest thereof.

3.2.9 Refund from Supplier

Sometimes, the suppliers, after claiming and receiving reimbursements for sales tax, excise duty, custom duty etc. from the purchaser, applies to the concerned authorities for refunds, on genuine grounds, of certain portions of such duties and taxes paid by it and receives the allowable refunds. Such refunds contain the purchaser's share also (out of the payments already made by the purchaser to that supplier). The tender enquiry document and the contract are to contain suitable provisions for obtaining such refunds from the supplier.

3.2.10 Payment against Time Barred Claims

Ordinarily, all claims against Government are time barred after a period of three years calculated from the date when the payment falls due unless the payment claim preferred has been under correspondence. However, limitation is saved if there is an admission of liability to pay, and fresh period of limitation starts from the time such admission is made. The drill to be followed while dealing with time barred claims will be decided by the Ministry/Department concerned in consultation with the Paying Authority. The Paying Authority is to ensure that no payment against such time barred claim is made till a decision has been taken in this regard by the competent authority.

4.0 CONCLUSION

To achieve what has been stated in the above paragraphs, it is essential that the purchase officials be provided with all the required rules, regulations, instructions, directives, and guidance on best practices in the form of a Manual. The manual should contain guidelines and directives concerning purchase of goods with public funds as well as some allied areas such as installation of equipment, operators' training, after sales services, maintenance contract, etc. Relevant aspects of purchase
management techniques have been incorporated in proper sequence under separate chapters.

5.0 SUMMARY

While claiming payment, the supplier is also to certify in the bill that the payment being claimed is strictly in terms of the contract and all the obligations on the part of the supplier for claiming this payment has been fulfilled as required under the contract. There should also be a suitable provision for verification of the authenticity of the person signing the invoice etc. for claiming the payment. Generally, irrevocable letter of credit is opened so that the supplier is fully assured of its payment on fulfilling its obligations in terms of the contract.

In case, the delivery date of the contract is extended to take care of delay in supply, for which supplier is responsible, the tenure of the letter of credit is also to be extended, but the expense incurred for such extension (of letter of credit) is to be borne by the supplier.

6.0 TUTOR MARKED ASSIGNMENT

The documents, which are needed from the supplier for release of payment, are to be clearly specified in the contract. What are these documents? Explain each one.

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UNIT 7: MODES OF PURCHASE, RECEIPT AND OPENING OF TENDERS---------------70

Content

1.0 INTRODUCTION

Public buying should be conducted in a transparent manner to bring competition, fairness and elimination of arbitrariness in the system. This will enable the prospective tenderers to formulate competitive tenders with confidence. The specifications of the required goods should be framed giving sufficient details in such a manner that it is neither too elaborately restrictive as to deter potential tenderers or increase the cost of purchase nor too sketchy to leave scope for sub-standard supply. The specifications must meet the essential requirements of the user department. Efforts should also be made to use standard specifications, which are widely known to the industry. In this unit, you will be exposed to the various modes of purchase to be adopted in any given transaction.

2.0 0BJECTIVES

At the end of studying this unit, you should be able to;

- Outline and explain in clear terms the various modes of purchase to be adopted in any given transaction.

3.0 MODES OF PURCHASE, RECEIPT AND OPENING OF TENDERS

3.1 General

Depending on the nature of the required goods, the quantity & value involved and the period of supply, the purchase organization is to decide the appropriate mode of purchase. The various modes of purchase to be adopted for this purpose are indicated in the subsequent paragraphs.

3.1.1 Approval of the competent authority to the purchase

Demand for Goods should not be divided into smaller quantities for making piece meal purchases for the sole purpose of avoiding the necessity of obtaining the sanction of higher authority required with reference to the estimated value of the total demand.

3.1.2 Purchase of Goods without Quotation

Purchase of goods upto a value of =N= 15,000 (Fifteen Thousand only) on each occasion may be made without inviting quotations/bids by the competent authority on the basis of a certificate to be recorded by him in the following format:

> "I, ________ am personally satisfied that these goods purchased are of the requisite quality and specification and have been purchased from a reliable supplier at a reasonable price."

3.1.3 Purchase of goods by Purchase Committee

Purchase of goods costing above =N= 15,000 (Fifteen Thousand only) and up to =N=1,000,000 (=N= One million naira only) on each occasion may be made on the recommendations of a duly constituted Local Purchase Committee consisting of three members of an appropriate level as decided by the Head of Department. The committee will survey the market to ascertain the reasonableness of rate, quality and specifications and identify the appropriate supplier. Before recommending placement of the purchase order the members of the committee will jointly record a certificate as under:

> "Certified that we ________________, members of the purchase committee are jointly and individually satisfied that the goods recommended for purchase are of the requisite

specification and quality, priced at the prevailing market rate and the supplier recommended is reliable and competent to supply the goods in question."

3.1.4 Purchase of Rate Contracted Goods

The Central Purchase Organization (e.g. DGS&D) will conclude rate contracts with the registered suppliers, for goods and items of standards types which are identified as common user items and are needed on recurring basis by various Ministries / Departments. The Central Purchase Organization (e.g. DGS&D) is to post the specifications, prices and other salient details of different rate contracted items, appropriately updated, on its web site for use by the procuring Ministries / Departments. The Ministries / Departments are to operate those rate contracts to the maximum extent possible. In case a Ministry / Department directly procures Central Purchase Organization's (e.g. DGS&D's) rate contracted goods from suppliers, the prices to be paid for such goods shall not exceed those stipulated in the rate contract and the other salient terms and conditions of the purchase should be in line with those specified in the rate contract. The Ministry / Department shall make its own arrangement for inspection and testing of such goods where required.

3.1.5 Preferential / mandatory purchase from certain sources or price preference to certain suppliers

As indicated eaarlier, Government has prescribed mandatory or preferential purchase of specified goods from specified suppliers or extension of price preference to certain categories of suppliers. *While making purchase of goods falling in these categories, the purchase organization should check the contemporary directives in this regard for necessary action.*

3.1.6 Purchase of Goods financed by Loans/Grants extended by International Agencies

The Articles of Agreement with the International Agencies, like the World Bank, Asian Development Bank etc. stipulate specific procurement procedures to be followed by the borrowers. The procurement procedures, as finalized and incorporated in the Agreements after consideration and approval of the Ministry of Finance are to be followed accordingly.

3.1.7 Purchase of Goods by obtaining Tenders

Except for the purchase of goods through the methods given in the preceding paragraphs, Ministries/ Departments shall procure goods within their delegated powers by following the standard method of obtaining tenders as follows:

(i) Advertised Tender Enquiry (ATI)

(ii) Limited Tender Enquiry (LTI)

(iii) Single Tender Enquiry (STI)

3.1.8 Advertised Tender Enquiry (ATI)

Subject to exceptions incorporated under the Limited Tender Enquiry and Single Tender Enquiry below, invitation to tenders by advertisement should be used for procurement of goods of estimated value into millions of naira and above. Advertisement (in the form of a Tender Notice) relating to ATI should be given in the national Trade Journal (ITJ) published by the Director General of Intelligence and Statistics and at least in one national daily having wide circulation. Further, an organization having its own web site is also to publish all its tender notices (relating to ATIs) on its own web site and provide a link with NIC web site. Additionally, for wider publicity, all Ministries / Departments should also publish their tender notices in the web site of Central Purchase Organization (e.g. DGS&D).

Where the Ministry / Department feels that the goods of the required quality, specifications etc., may not be available in the country and/or it is also necessary to look for suitable competitive offers from abroad, the Ministry/Department may send copies of the tender notice to the Nigerian Embassies abroad as well as to the Foreign Embassies in Nigeria requesting them to give wide publicity of the requirement in those countries.

They may also be requested to put the tender notice in their web sites. The selection of the embassies will depend on the possibility of availability of the required goods in such countries. Publicizing the requirement globally as above is also known as **Global Tender Enquiry**.

Ordinarily, the minimum time to be allowed for submission of bids should be three weeks from the date of publication of the tender notice or availability of the bidding document for sale, whichever is later. Where the department also contemplates obtaining bids from abroad, the minimum period should be kept as four weeks for both domestic and foreign bidders.

3.1.9 Text of Tender Notice

The tender notice for an ATI should be carefully drafted. It should contain all the salient features of the requirement in brief to give a clear idea to the prospective tenderers about the requirements. Superfluous or irrelevant details should not be incorporated in the tender notice, as it will increase the cost of the advertisement. The Tender Notice should contain:

- Description and specification of the goods and quantity
- Period and terms of delivery
- Cost of the tender/bidding document

- Place(s) and timing of sale of tender documents
- Place and deadline for receipt of tenders
- Place, time & date for opening of tenders
- Amount & Form of Bid Security / Earnest Money Deposit
- Any other important information

3.1.10 Cost of Tender Documents

Price of the tender document should take care of the preparation and delivering cost only. If it is too high, it will discourage the prospective bidders to purchase the document and participate in the bidding process.

3.1.11 Sale of Tender Documents

Tender documents should preferably be sold upto one day prior to date of opening of tenders and the same should be clearly indicated in the documents. The organization should also post the complete tender document in the web site and permit prospective tenderers to make use of the document downloaded from the web site. If the tender document is a priced one, there should be clear instructions for the tenderers in the document (which has been downloaded) to pay the amount by demand draft etc. along with the tender, prepared in the downloaded document.

The sale of tender documents against ATI should not be restricted and should be available for sale freely. The purchase organization shall maintain proper records about the number of tender documents sold, list of parties to whom sold, details of the amount received through sale and, also, the number of unsold tender documents, which are to be cancelled after the opening of the tenders.

3.1.12 Limited Tender Enquiry (LTI)

This method may be adopted when estimated value of the goods to be procured is up to millions of naira. Copies of the bidding document should be sent, free of cost, directly by speed post/registered post / courier/e-mail, simultaneously to all the firms, which are borne on the list of registered suppliers for the goods in question. The number of supplier firms in LTI should be more than three. Efforts should be made to identify a higher number of approved suppliers to obtain more responsive bids on competitive basis. Web site publicity should also be given for LTIs; however, the Ministry / Department can limit the access of the tender documents to only the selected prospective suppliers by issuing them password to have access to the document.

Purchase through LTI may be adopted even when the estimated value of the procurement is more than millions of naira, in the following circumstances:

(a) The competent authority in the Ministry / Department certifies that the demand is urgent and any additional expenditure involved by not procuring through advertised tender enquiry is justified in view of urgency. The Ministry / Department should also put on record the nature of the urgency and reasons why the procurement could not be anticipated earlier.

(b) There are sufficient reasons, to be recorded in writing by the competent authority, indicating that it will not be in public interest to procure the goods through advertised tender enquiry.

(c) The sources of supply are definitely known and possibility of fresh source(s) beyond those being tapped is remote.

(d) Nature of items to be procured is such that pre-verification of competence of firm is essential, hence requires registration of firms. Sufficient time should be allowed for submission of bids in Limited Tender Enquiry cases.

3.1.13 Pre-bid Conference

In case of turn-key contract or contract of special nature for purchase of sophisticated and costly equipment, a suitable provision is to be kept in the tender enquiry document for a pre-bid conference for clarifying issues and clearing doubts, if any, about the specification and other allied technical details of the plant, equipment and machinery projected in the tender enquiry document.

The date, time and place of pre-bid conference should be indicated in the tender enquiry document for information of the interested tenderers. This date should be sufficiently ahead of tender opening date.

3.1.14 Format of Tender

The tenderers are to furnish their quotations as per the prescribed format and also as per the instructions incorporated in the tender documents. Quotations sent by telex, cable or facsimile are to be ignored and rejected.

3.1.15 Sealing and Marking of Tenders

The tender document is to indicate the total number of tender sets (e.g., in duplicate or in triplicate etc) required to be submitted. The tenderer is to seal the original and each copy of the tender in separate envelopes, duly marking the same as “original”, “duplicate” and so on and also putting the address of the purchase office and the tender reference number on the envelopes. Further, the sentence ‘’NOT TO BE OPENED” before……….. (due date & time of tender opening) are also to be put on these envelopes. The inner envelopes are then to be put in a bigger outer envelope, which will also be duly sealed marked etc. as above. If the outer envelope is not sealed and marked properly as above, the purchaser will not assume any responsibility for its misplacement, premature opening, late opening etc. All the above instructions are to be suitably incorporated in the tender documents.

3.1.16 Extension of Tender Opening Date

Sometimes, situations may arise necessitating modification of the tender documents already issued (LTI case) or already put on sale (ATI case). Also, after receiving the documents, a tenderer may point out some genuine mistakes necessitating amendment in the tender documents. In such situations, it is necessary to amend/modify the tender documents suitably prior to the date of submission of bids. Copies of such amendment / modification should be simultaneously sent to all the selected suppliers by registered/speed post/courier/e-mail in case of LTI. In case of ATI, the copies of such amendment / modification are to be simultaneously despatched, free of cost, by registered/speed post/courier/e-mail, to all the parties who have already purchased the tender documents and copies of such amendments are also to be prominently attached in the unsold sets of the tender documents (which are available for sale), including the tender documents put in the web site.

When the amendment/modification changes the requirement significantly and /or when there is not much time left for the tenderers to respond to such amendments, and prepare revised tender, the time and date of submission of tenders are also to be extended suitably, along with suitable changes in the corresponding time-frames for receipt of tender, tender validity period etc and validity period of the corresponding EMD/bid security. Depending on the situation, such an amendment may also need fresh publication adopting the same procedure as for publication of the original tender enquiry.

3.1.17 Amendments / Modifications to Tenders

The tenderer, after submitting its tender, is permitted to submit alterations/modifications to its tender so long such alterations/modifications are received duly sealed and marked like original tender, upto the date & time of receipt of tender. Any amendment/modification received after the prescribed date and time of receipt of tenders are not to be considered.

3.1.18 Receipt and Custody of Tenders

Receipt and custody of tenders shall be done in a transparent manner. Tenders are to be received though tender box and, in its absence, by hand delivery to the nominated officials of the purchase department. The tender box should be located in a place, which is easily accessible to the parties for dropping their tenders. The tender box shall have two locks. Key of one lock will be with the head of the office and the other key with the official nominated by him. On each occasion of tender opening, the tender box will be opened by two officials at the prescribed date and time (as per the date & time specified for receipt of tenders) and the relevant tenders will be taken out. In the tender box, there may be tenders for other cases due for opening later; such tenders are to remain in the tender box under lock and key. The tenders so taken out are to be entered in a gazette in duplicate duly signed with date and time by the two officials and sent to the officials authorized to open the tenders. Signatures of the receiving officials will be obtained on the duplicate copy of the challan for record. There should be at least two officials nominated for opening of tenders.

There may be cases where the tenders are too bulky to be put in the tender box or the purchase office is yet to install tender box and, therefore, the tenders are to be submitted by hand. In such cases, it should be ensured that names and designations of at least two officers, who will receive the tenders, are prominently mentioned in the tender documents. The information about these officers should also be displayed at the entrance / reception of the premises where tenders are to be deposited. The officer receiving a tender is to give the bearer of the tender a receipt duly signed by him with date and time of receipt of the tender.

A separate register is to be maintained for keeping records of the bids, received by hand. Such bids will be kept in safe custody with the head of the office or his authorized representative till the date and time of bid opening and then such bids will be handed over to the bid opening officer, in identical manner as mentioned in the previous paragraph. Sometimes, tenders are also received by post. Such tenders shall be received and documented in identical manner as applicable for tenders received through hand delivery.

3.1.19 Late Tender

In the case of advertised tender enquiry or limited tender enquiry, late tenders (i.e., tenders received after the specified date and time for receipt of tenders) should not be considered.

3.1.20 Opening of Tenders

All the tenders received on time shall be opened in the presence of authorized representatives of the tenderers (who have submitted regular tenders) at the prescribed time, date and place. The authorized representatives, who intend to attend the tender opening, are to bring with them letters of authority from the corresponding tenderers. Tenders should be opened immediately after the deadline of receipt of tenders with minimum time gap in between. At least two duly authorized officials of the purchase department should jointly open the tenders. The tender opening officials are to announce the salient features of the tenders like description and specification of the goods, quoted price, terms of delivery, delivery period, discount if any, whether EMD furnished or not and any other special feature of the tender for the information of the representatives attending the tender opening.

After opening, every tender shall be numbered serially, initialled, and dated on the first page by all the officials authorized to open the tenders. Each page of the price schedule or letter attached to it shall also be initialled by them with date, particularly the prices, delivery period etc., which shall also be circled and initialled with date. Blank tenders, if any, should be marked accordingly by the tender opening officials. The original, duplicate, triplicate copies in a tender set are to be marked accordingly by the tender opening officials.

Alterations in tenders, if any, made by the tenderers, shall be initialled with date & time by the officials opening the tenders to make it perfectly clear that such alterations were present on the tenders at the time of opening. Wherever any erasing or cutting is observed, the substituted words should also be encircled and initialled with date & time to make clear that such erasing/cutting of the original entry was present on the tender at the time of opening.

3.1.21 Responsibility of the Tender Opening Officials

In addition to what has been mentioned above, the tender opening officials will prepare a list of the representatives attending the tender opening and obtain their signatures on the same. The list will also contain the representatives' names and the corresponding tenderers' names and addresses. The authority letters brought by the representatives will be attached with this list. This list will be signed by both the tender opening officials with date & time.

An on-the-spot report containing the names of the tenderers (serial number wise) salient features of the tenders, as read out during public opening of tenders will be prepared by the tender opening officers duly signed by them with date & time. The tenders, which have been opened, the list of the representatives attending the tender opening and the on-the spot report are to be handed over to the nominated purchase officer and acknowledgement obtained for the same.

4.0 CONCLUSION

To achieve what has been stated in the above paragraphs, it is essential that the purchase officials be provided with all the required rules, regulations, instructions, directives, and guidance on best practices in the form of a book. This unit was focused to serve this objective.

5.0 SUMMARY

This unit contains guidelines and directives concerning purchase of goods as well as some allied areas such as installation of equipment, operators' training, after sales services, maintenance contract, etc. Relevant aspects of purchase management techniques have been incorporated in proper sequence under separate subsections. This arrangement will help you to readily achieve the knowledge necessary on the modes of purchase, receipt and opening of tenders.

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6.0 TUTOR MARKED ASSIGNMENT

How do you understand the concept of tender notice? What information should be contained in the tender notice?

7.0 REFERENCES

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UNIT 8 PURCHASING PRACTICE AND METHODS – (I)-------------------79

Contents

1.0 INTRODUCTION

Procurement has long been considered one of the basic functions common to all organisations. Retailers, wholesalers, and in certain cases, service establishments, buy merchandise to sell to their customer. Manufacturer purchase the materials they use in their production processes. In all cases, purchasing is vital to the success of the business; without an adequate supply of merchandise and / or materials, the firm would be unable to operate at maximum efficiency. A company procurement function becomes particularly important when: 1) Its purchased items account for a high proportion of the unit cost of the product. 2) When the price fluctuate widely 3) When numerous diverse items are needed 4) When the quality of the materials appreciably influences the cost of manufacturing. Regardless of the type of business, procurement and supply work is divided naturally into five distinct classifications, each of which encompasses a fairly wide range of activities. The five classifications of works found in a procurement operation are:

1) Management Management of the purchasing function involves all the tasks associated with the management process.

2) Buying This includes a wide variety of activities, such as working with users to help develop requirements and specifications, reviewing requisitions, analysis specification, investigating supplier, studying costs and prices, analysis of bids and negotiation and selecting suppliers. Some companies have expanded the buying job and now see it as supplier management.

3) Follow-Up and Expediting Other follow-up activities involves various types of supplier liaison work, such as reviewing the status of orders, writing letter, telephoning and faxing suppliers, and occasionally visiting supplier's plant.

4) Strategic Planning and Research Work

The more an organisation progresses toward a purchasing management focus, the more emphasis it places on these strategic activities.

5) Clerical activities

Every department must write orders and must maintain working files, catalogue and library materials, and records for commodities suppliers, price and so on.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

1) state and explain how the need to procure different materials arise
2) discuss the issues involved in purchasing capital goods; in leasing arrangement; in buying used equipments, and in buying for resale
3) explain the meaning and factors influencing future dealing, sub-contracting and the purchase of services
4) highlight and comment on the keys to a successful service contract administration.

3.0 MAIN CONTENT

3.1 Origin of the Need to Purchase

Every purchase transaction originates with the recognition of the need for an item by someone in the enterprises. This need may originate in the department using the materials. The office manager may want a new typewriter. Quite often, the need for the material may be satisfied by transfer of materials from one to another department or drawing it from the stores. However, eventually the stores must replenish its supplies of the items issued to the user. Thus one may say that directly or indirectly, purchases originate from the recognition of need for an item by a user department. In regard to most items, an efficient purchasing department will anticipate the needs of user departments.

To however appreciate the range and variety of materials needed in an organisation, an examination of the wide range to needs that cover all types of business organisation whether in the private or public sector of the economy becomes very necessary. It is therefore possible to easily and broadly identify and discuss two bases for product classifications; the product based (goods and services) and the user-based (consumer and industrial goods).

3.1.1 Product Classification

There are many ways to categorise products, the most basic being to distinguish between goods and services. Another common approach among markets is to distinguish between consumer and industrial goods.

(a) Product-Based Classification: Product-based classification groups together products that have similar characteristics, although, they may serve different purposes and markets. There are three main categories:

(1) Durable Products: Durable products last for over a long period before having to be replaced.

(2) No-durable Products: Non-durable products can only be used once or for a few times before they have to be replaced.

(3) Service Products: Services represent intangible products comprising activities, benefits or satisfactions that are not embodied in physical product.

(b) User-Based Classification

This classification deals with consumer markets (goods purchased for personal or family consumption) and industrial or organisational markets (goods purchased for business or institutional use).

Industrial Goods and Services

Industrial products are goods purchased by organisations or institutions that are used in the process of manufacturing other goods. Those that are more expensive and have a longer useful life are considered capital items. Industrial goods are more usefully classified in terms of how they enter the production process and their relatively costliness. The following industrial items can be easily identified:

1) Capital Goods

Capital equipment consists of all the buildings and fixed equipments that have to be in place for production to happen. They are industrial goods that enter the finished product partly, and there are two group: installation and accessory equipment.

2) Raw Materials

These are industrial goods that enter the manufacturer's products completely. Raw materials arrive more or less in their natural state, having been processed only sufficiently to ensure their safe and economical transport to the factory. The raw material then go on to further processing within the purchaser's own production line.

3) Components and Parts

Components and parts are finished goods in their own right, which simply have to be incorporated into the assembly of the final product with no further processing. Car manufacturers for example buy in headlamp units, plugs, alarm system, and tyres as complete components or parts and then fit them to the cars on the assembly line.

4) Supplies and Services

There are several categories of minor consumable items (as distinct from the accessory goods) and service that facilitate production and the smooth running of the organisation without any direct input.

a) Operating Supplies: These are frequently purchased consumable items that do not end up in the finished products.

b) Maintenance and Repairs: These are industrial services that ensure that all the capital and accessory goods continue to operate smoothly and efficiently.

c) Business Services: These involve the purchase of service like management consultancy, accounting and legal advice and advertising agency expertise.

The above list is not exhaustive, but by examining its contents in terms of purchasing responsibilities in different organisations or industries, it becomes clear that needs must be recognized, authorised and satisfied in a variety of ways. In order to clarify this, it is first advisable to classify all requirements into groups, which have common characteristics and require similar treatment. All basic needs are thus classified into three main groups according to their common characteristic:

(a) Needs, which entail capital expenditure such as buildings, machines, vehicles, furniture, etc.

(b) Needs for production materials, which go directly into the finished product.

(c) Needs for miscellaneous suppliers, which are supplies other than production materials required to operate the business.

It can therefore be seen immediately that these three classes of needs will arise in different circumstances and at different place in the company.

3.1.2 Authority to Purchase

According to Menon K.S. (1993), when the aspects of authority in matters relating to purchases are discussed, there are usually two separate groups of people who are involved. They include:

1) The authority of the person who needs the items to make requisition for the item. This person may be the actual user (e.g. the plant foreman), or it may be the stores officer in charge of the stores where the item is stocked.

2) The second one is the authority vested in officers of the purchasing department for making purchase of the items required.

The authority to purchase is basically related to its status as a service department orientated towards catering for the supply requirements of various departments by making purchases of materials, equipments etc. which they need. There are three ways in which a user department or store authorises the purchasing department to make purchases for them:

• By means of a purchase requisition often called the materials indent form;

• By means of a permanent order card or travelling requisition.

• By means of a bill of materials or parts list made in conjunction with production department.

1) The Purchase Requisition When a department or store needs a particular material, which may be raw materials or equipment or stationery, it prepares a material requisition usually on the Materials Indents Form. This form is usually prepared in duplicate being retained by the requisitioning department for reference and follow-up. The purchase requisition should provide the following essential information:

(a) Specification
(b) Quantity
(c) Delivery
(d) Work Order Reference
(e) Materials Indent Form
(f) Signature

2) The Permanent Order Card or travelling requisition SS (TR)

This methods or requisitioning is used for materials purchased on repeat basis or for standard stock items, i.e., items which are stocked on a regular basis in the stores. This is a permanent card with all details on the materials recorded inside it. Each time a quantity is needed, the card is sent to the purchasing department indicating the quantity or volume required.

A Travelling Requisition (TR) on the other hand carries all relevant information required to enable the purchasing department to place orders for fresh supplies.

When stock level reaches the re-order level, the stock control clerk sends the TR to the purchasing department. When the TR is received, the purchasing department swings into action. It decides upon the source from which the purchase is to be made, as well as the quantity that is to be ordered, and then passes the card on for typing out the purchase order.

3) Bill of Materials or Part List

When the design department designs a particular product, a list of the various materials, which are required to make that particular product, is made out. This is called a Bill of Materials or Part List. When a production schedule is prepared, it is usually converted into a Bill of Materials which will show exactly what materials are required and when. The purchasing department can then establish the total material requirements and determine when exactly each would be required and in what quantities. In some cases, the Bill of Materials is routed to the purchasing department through the stock control department who will indicate which items on the list are regular stock items and which items have to be purchased. The purchasing department then takes out the remaining requirements from the bill of materials and places the purchase orders that are necessary.

3.2 Purchasing Capital Goods

Modern advanced industrial technology rests upon the use of vast amount of capital: elaborate machinery, large-scale factories and plants, stores and stocks of finished and unfinished materials.

Capitalism got its name because this capital or productive wealth is primarily the private property of somebody – the capitalist. Capital, which is the word often used to refer to capital goods generally, is a different kind of production factor. A capital good differs from the primary factor (such as land, labour) in that neither land nor (these days) labour is regarded as result of the economic process; but instead, exist primarily by virtue of physical and biological, rather than economic factors. Capital is on the other hand, an input which is itself the output of the economy. Capital goods then represent produced goods that can be used as factor input for further production. In most firms capital equipment is not purchased every day – but when it is, such represent important management decisions as a rule, these purchases are major investments.

1) Investments that lead to improved productivity, and or
2) To the manufacture of more competitive products that increase sales in the market place.

3.2.1 Factors to Consider in Buying Capital Equipment

Apart from the mode of purchase, finance and the investment made, Lysons, K (2000, p. 323) argued that the factors to be considered should include the following:

1) Purpose: what is the prime purpose of the equipment?
2) Flexibility: How versatile is the equipment.

3) Standardisation: is the equipment compatible with any already installed, thus reducing the cost of holding spares?
4) Life: This usually refers to the period before the equipment will have to be written off due to depreciation or obsolescence. It is, however, not necessarily linked to the total life span if it is intended to dispose of the asset before it is obsolete or unusable.
5) Reliability
6) Durability
7) Product quality
8) Cost of operation: Costs of fuel, power and maintenance.
(9) Cost of installation
10) Cost of maintenance
11) Miscellaneous
12) Life cycle costing (Terotechnology) is an important aspect of capital expenditure.

Chartered institute of Management Accountant (CIMA) has defined life cycle costing as:

The practice of obtaining over their life time the best use of the physical assets at the lowest cost to the entity (Terotechnology). This is achieved through a combination of management, financial, engineering and other disciplines.

The term **'Terotechnology'** coined in 1970 is derived from the Greek verb tereo and literally means 'the art and science of caring for things.' Life cycle costs are therefore those associated with acquiring, using, caring for and disposing of physical assets, including feasibility studies research, development, design, production, maintenance, replacement and disposal, as well as the associated support, training and operating cost incurred over the period in which the asset is owned.

3.2.2 Purchase and Product Characteristics of Capital Goods The role of the purchasing department is distinctly different in the buying activity of capital goods than it is in production buying. The peculiar characteristics of capital goods make both the purchase of capital equipments and the product itself differ in a number of ways. This includes:

(1) This fundamental difference between capital and non-capital goods is a time difference.

No capital goods represent expenditure on current needs, and goods of this kind are used up in a relatively short time. Capital goods represent investment in fixed as sets or capital assets, which will be used for a relatively long-time.

(2) Some of the items of capital goods are high specialised and are built in order to meet the needs of buyers: others are more or less standardised and are used by a number of different industries.

(3) Capital goods have initial high price, and commitment to one capital project means that others have to be turned down.

(4) In evaluating capital goods, buyer will consider such properties as productivity, versatility, durability, economy of operation and maintenance, and time and labour-saving features.

(5) Acquisition of capital goods is frequently subjected to the participation of various executives in the buying firm, because the equipment is of high value and of great significance to the buyer.

(6) Sales of capital goods are largely through direct buyers because of:

(a) The small numbers of users

(b) The concentration of the demand market

(c) The large unit of sale

(d) The need for most effective communications with sellers to enable speedy negotiation of particular needs

(e) The need to provide various types of service (e.g. installation advice the supply and training of operators).

(7) Another special characteristic is that expenditure on most capital goods is personable. Just as the individual consumer can postpone the replacement of his car or refrigerator until next year, so a manufacturing organisation can postpone the replacement of an old machine tool until prospect looks brighter or the financial situation is better.

(8) Creation of demand is difficult for the supplier or seller as the capital equipment will only be required in connection with new plant, for expansion or replacement.

(9) Most organisations use special requisition forms for capital purchases because of these special characteristics. The procedure for authorising the expenditure tends to be more formal; often a director’s signature is required.

3.2.3 The Role of Purchasing Department in the Procurement of Capital Goods

Peter Baily et al (1981:224) argued that the purchasing executive is the key figure in communications between his organisation and supplier. Although policy in regard of the purchasing department’s role varies widely between companies, one basic area of consideration is the calibre and competence of the people who constitute the department. Many small purchasing departments play a clerical role only, while others are able to make useful contributions to the whole process of considering, deciding upon, and actually undertaking the project.

Large organisations which employ substantial procurement personnel and make numerous purchases of plant and equipment usually have specialist buyers who have built up extensive market knowledge and considerable expertise in the negotiation and administrations of capital contract.

The procurement of capital equipment calls for purchasing personnel that functions in a creative capacity as facilitators and coordinators. David N. Burt et al (1996:399) summarized key points of purchasing role in a typical capital equipment purchase. This includes:

1) Participate in the preliminary discussion phase, including solicitation of information and budgetary estimates.

2) Review and request clarification of specifications. Specification must be precise and complete, and they must be written as functionally as possible.

3) Coordinate the development and qualification of potential supplier, including various qualitative analyses. The purchasing executive must first determine, usually with engineering assistance, the level of a supplier's technical and production capabilities. This is of utmost importance.

4) Compile required commercial terms and conditions.

5) Prepare and process the request for proposal from potential suppliers.

6) Coordinate the analysis of supplier proposal, including economic analyses and the resolution of any exceptions to specifications. Economic analysis of each machine must be made, relating its ultimate cost to its productivity. Several measures or profitability can be used, the payback approach being the most common or any of the more sophisticated discounting cash flow (DCF) approaches. Economic analyses must be thorough, and must be based on accurate data.

7) Arrange for side-by-side demonstration, if practicable.

8) Plan, coordinate, and conduct negotiations as necessary. After management has approved a proposal for the purchase of capital equipment, the buyer assumes his/her customary responsibility for negotiating the final price, and related terms of the contract.

9) Coordinate and conduct contract inspection and expediting services.

10) Critique and document supplier's performance by means of objective vendor rating exercise.

11) Maintain records of price and delivery trends for future procurements.

The purchasing executive contributes directly to the accomplishment of some of these activities. More important, however is his or her responsibility to orders and coordinate the total performance. The buyer's main job is to ensure that every thing happens as it should.

3.3 Acquisition of Used Equipment

A buyer is by no means restricted to the purchase of new capital equipment. The existing used equipment available from supplier auction or direct purchase from a previous owner may be an alternative to purchasing new equipments. Purchases of used equipment, in fact, constitute an important percentage of total machinery sales. Used equipments are available for a number of legitimate reasons.

a) When a firm buys a new machine, it frequently disposes of its old ones.

b) A firm that extensively modifies its product design or its total production process is in a better to position to obtain more specialised production equipment and hence put up the old ones for sale.

c) Some use equipments equally becomes available because the owner lost a particular contract or has discontinued operation altogether.

3.3.1 Used Equipment Sources

Lamer Lee Jr. et al (1981) listed four sources from which used equipment is available and commonly purchased:

(i) Used Equipment Dealers

Used equipment dealers sell two types of machine viz, reconditioned machines and rebuilt machines. Generally speaking, a reconditioned machine carries a dealer's guarantee and sells for about half or less of the price of a similar new machine. A rebuilt machine typically carries a more inclusive dealer warranty and sells for perhaps half for even more than a new machine's price.

(ii) Directly from the Owner

Some owners prefer to sell their used equipment directly to the next user because they feel they can realise a higher price than by selling to a dealer. Some buyers also prefer this arrangement. It permits them to see the machine in operation and learn something about its usage history before making the purchasing decision.

(iii) Brokers Occasionally, an industrial supply house or a manufacturer's agent will act as a broker for a good customer by helping him dispose of an old piece of equipment which has a limited sales market.

(iv) Auction Auction represents still another source of used equipment. When a commodity is sold by auction, prospective buyers make bids. It is commonly being sold to the person making the highest bid. Generally speaking, buying at auction is somewhat more risky than the other supply sources because:

a) Auction machine usually carries no warranty, and so there can be no return after sales.

b) It is rarely possible to have the machine demonstrated

c) Buyer's lack of perfect knowledge about the goods bided for.

d) Absence of after sales services. It is therefore advisable that industrial buyers must have a spending limit and should avoid always buying at auction because of its inherent risks or shortcomings. Two types of auction are common. These are open and closed auction.

3.3.2 Reasons for Purchasing Used Equipment

A purchaser may have several reasons for deciding to buy used equipment. Some of the important reasons include:

(1) The cost of used machinery is substantially less than that of new equipment.

(2) Used equipment is frequently more quickly available than new equipment. In some situations, availability may override all other consideration.

(3) Used equipment, especially when reconditioned and rebuilt, may have a long life and be protected by warrants.

(4) Another common reason for the purchase of used equipment is that used equipment adequately satisfies the purchaser's needs, in which case there is no point in buying new equipment.

3.3.3 Cautions in Purchasing Used Equipment

The age-old adage of caveat emptor – let the buyer beware – is particularly applicable when purchasing used equipment. Though, protection is given by the sales of goods, misrepresentation and Trade descriptions Acts; the buyer of used equipment should work on the principle of Caveat emptor.

As a procedural guide, the buyer of used equipment should be able to ask some of the following questions:

1) Is the usage history of the equipment available?

2) Are component and parts readily available? Will they continue to be?

3) Is there any indications of the equipment age such as serial number?

4) How well has the equipment been maintained over the usage period?

5) What will be the cost, where appropriate, of dismantling, transporting and re-erecting or installing equipment?

6) How does the price asked for used equipment compare with the cost of buying new one?

7) Does any warranties supersede the protection given under the Sale of goods Act?

8) What trials, test or approval period will the vendor allow?

9) What special term conditions, if any apply to the purchase?

The above questions are by no means exhaustive. A purchaser of used equipment may ask more questions than the aforementioned ones. This depends on the personal intelligence endowed to the buyer. Generally speaking, it is difficult to determine the true condition of a used machine and to estimate the type and length of service it will provide. For this reason, it is:

1) Wise to have one buyer specialise in used equipment.

2) Moreover, it is virtually essential to enlist the cooperation of an appraising used equipment.

3) In preparing a purchase order for used capital equipment, care must be taken to include all essential data.

4.0 CONCLUSION

There is no gainsaying that purchasing has been an important aspect of management, be it business management or management of non-profit. In contemporary business operation, how well an organisation does its buying may spell the difference between profit and loss. Indeed, there is an old proverb, Goods well bought are sold. This is literally true in the purchasing function of a manufacturer, purchasing raw materials and equipment or in the purchasing function of merchant middlemen whether wholesalers or retailers. Even in the modern consumer market, particularly, for sophisticated goods, e.g. specialty goods, the purchasing function is very important; purchasing however has a wider meaning. It is more than mere buying. It is considered a managerial activity and it includes planning, organisation and control of a wide range of interrelated activities. Purchasing is very closely related to production as well as marketing departments of an organisation. All these three functional areas of business must work in cooperation to fulfill the company-wide targets.

5.0 SUMMARY

Modern advanced industrial technology rests upon the use of vast amounts of capital: elaborate machinery, large-scale factories and plants, stores and stocks of finished and unfinished materials. Capitalism got its name because this capital or productive wealth is primarily the private property of somebody – the capitalist. There is no single market for industrial goods, but several markets. Industrial buyers tend to base their selection of goods and services on objective criteria. The industrial buyer buys a vast variety of goods and services. Some goods and services are relative expensive and are generally used within a year of purchase. Those that are more expensive and have a longer useful life are considered capital items. Every purchased transaction originates with the recognition of the need for an item by someone in the enterprise. This need may originate in the department using the material.

6.0 TUTOR-MARKED ASSIGNMENT

What factors would you advise you advise your company to consider in the purchase of capital goods?

7.0 REFRENCES/FURTHER READING

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UNIT 9 PURCHASING PRACTICE AND METHODS – (II)---------------92

Content

1.0 INTRODUCTIION

The specific form of material organisation most appropriate for one company may not be the best form for another company, a brief discussion of two materials activities will illustrate why the unique nature of a specific firm's ;operating activities influences its form of material organisation so heavily. Assume that a plant purchases all the parts, components and subassemblies for the product it manufactures. In this situation, if production were uniform, the production planning schedule and the purchasing schedule would be similar or identical. Consequently, for this firm to achieve optimal materials and cost control production control should realistically be included in the materials management department. Assume now that a plant manufactures all the parts, components, and subassemblies that are used in turning out its product. In this situation, there may be very little similarity between the production planning and purchasing schedules. Therefore, in this firm, a strong case could be made for locating production control within the production department.

2.0 OBJECTIVE

At the end of studying this unit, you should be able to:

1) Define leasing as an option regarding equipment acquisition
2) Explain the technicalities of buying for resale
3) Discuss the increasing importance of subcontracting in the purchase of services
4) Outline and explain the issues involved in the purchase of services

3 .0 PROCUREMENT PRACTICE AND METHODS CONTENTS - II

3.1 LEASING

The purchasing manager may be involved in deciding upon the most appropriate method of acquiring a set of equipments or replacement of equipments for the organisation. The method selected will be affected by the following major consideration; The three options regarding equipment acquisition are: (i) Leasing (ii) Hiring (iii) Outright purchase. Product leasing is not a new way of doing business. Leasing is a means whereby a firm may acquire the use of equipment without the necessity of taking title. As a concept, a lease has been defined by the Equipment Leasing Association as: *"A contract between lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such assets by the lessee."*
The lessor retains ownership of the asset. The lessee has possession and use of the asset on payment of specified rentals over a period.

The agreement with the owner to use the property is a lease. The owner is the lessor and the person taking possession is the lessee. The equipment remains the property of the lessor but responsibility for its maintenance is the duty of the lessee. Under the status for Frauds, a lease for longer than a year must be put in writing to be enforceable. The more formal written lease usually contains the following:

1) Date of agreement
2) Names of lessor and lessee
3) Property description
4) Duration of lease
5) Manner of paying rent
6) Responsibility for making repairs
7) Liability for injury to third party

8) Right to sublet or resign

3.1.1 Types of Leasing Arrangement

Lease agreements have become popular methods for financing both small and large enterprises, and it is carried on under a number of types of arrangement. The following are almost certainly the most common.

1) By Maker to User

The manufacturers of equipments such as data processing equipment usually lease directly to users as a means of marketing their products, which are often highly specialised and technical.

2) By One User to another User

3) By Leasing Company to a User

The arrangement of leasing by one user to another user is somewhat cumbersome and depends on cooperation between firms that often compete with one another. The result has been the emergence of firm that buys machines from the equipment makers and leases them to users.

4) By a Finance House to User

In this type of leasing agreement, the lessor has no commercial interest in the transaction other than as a supplier of finance. The lessor pays for the asset and thereby become its owner.

3.1.2 Advantages of Leasing

There are several advantages to the leasing method and it is an increasingly popular option.

(a) No capital commitment: The organisation will not have to find large sums of money to acquire the equipment.

(b) Low cost: The leasing method of acquiring equipment is the lowest of the three options (i.e. leasing, hiring and outright purchase), and this is an advantage.

(c) Leasing enables the suitability of equipment to be assessed over a predetermined trial period. **(d) Leasing provides an edge against the risk of obsolescence.**

(e) Replacement decisions are made easier.

3.1.3 Disadvantages of Leasing

(a) The lessee has to maintain the equipment: This can be very expensive

(b) Fixed term contract: The equipment cannot be returned to the lessor in the event of change in the lessee's business needs.

(c) Leasing does not provide the prestige of ownership.

(d) Resale value: In time of inflation, ownership is generally at an advantage because the resale value rises with inflation.

3.2 Buying for Resale

Buying goods (or merchandise) for resale has much in common with other kinds or purchase; even though purchasing for resale is one vital aspect where the business function of marketing and procurement considerably overlap. Sometimes described as speculative buying, buying for resale is a process that involves reselling the merchandise bought, in most instances, without anything being done or any value being added to the purchased item. Buying for resale is the glamour job in retailing. It is an activity, which owes more to marketing than purchasing. What retailers, wholesalers or other members to the distributive sector but they also sell.

Important Consideration

Generally speaking, the decision as to what to buy must frequently be taken with a strong feeling for what to sell. This is because, decision in the buying for resale practice has to be made in terms of what to buy, quantities, prices, delivery terms, and mode and timing of payment. In deciding what to buy, the first major task is to apply marketing research. In specific term, marketing research has been defined as: “the systematic gathering, recording and analysing of data about problems in marketing goods and services”. This major activity will help satisfy the resale buyer’s unending need for information about the market, sources of supply, the goods etc. All retailers need to plan what goods to sell for. In most cases, what a business sells is what that business is. The terms merchandising and buying are used interchangeably. And in developing a range of merchandise (i.e. the product mix; a group of related products) a resale buyer should consider such questions as: (a) Is this product suitable for our store image? (b) Is it appropriate for our target markets? (c) What is the likely demand for the product?
(d) How readily is the product group available?
(e) On what terms could we buy it?

3.3 Future Dealing

According to Lyson (2000:335), a commodity such as copper may be bought directly from the producer or on a commodity market. The latter (i.e. the commodity market) provides the advantages of futures dealing. The London markets for example are divided into two main areas: metals and soft commodities. The non-ferrous metal markets in copper, tin, zinc, and silver operates at the London Metal Exchange

(LME). The soft commodity markets dealing in cocoa, coffee, sugar, vegetable oils, wool and rubber are situated at the Corn Exchange building.

The Functions of Exchanges

(1) To enable customers, merchants and dealers to obtain supplies readily and at the competitive marketing price.

(2) To smoothen our price fluctuation due to change in demand and supply

(3) To provide insurance against price fluctuation through the procedure known as 'hedging'

3.3.1 The Purpose of and Conditions for Future Dealing

The purpose of future dealing is to reduce uncertainty arising from price fluctuation due to supply and demand changes. This reduction in uncertainty benefits both producers and consumers. The producer can sell forward at a sure price; the consumer can buy forward and fix materials cost in accordance with a predetermined price. Manufacturers of copper wire, for example, might be able to obtain an order based on the current price of copper. If they think the price of copper may arise before they can obtain their raw materials they can immediately cover their copper requirements by buying on the LME at the current price for delivery three months ahead, thus avoiding any risk of an increase in price.

For future dealing to be undertaken the following conditions must apply:

(1) The commodity must be capable of being stored without deterioration for a reasonable period.

(2) The commodity must be capable of being graded for the purpose of providing a basis for description in the contract

(3) The commodity must be tradable in its raw or semi-raw state

(4) Producers and consumer must approve the concept of futures dealing

(5) There must be a free market in the commodity, with many buyers and sellers, making it impossible for few traders to control the market and thus prevent perfect competition.

3.3.2 Some Terms Used in Futures Contracts 1) Arbitrage The (usual) simultaneous purchase of future in one market against the sale of future in a different market to profit from a difference in price.

2) Backwardation The backwardation situation exists when forward price are less current 'spot' ones.

3) Contango A contango situation exists when forward prices are greater than current 'spot' ones.

4) Force Majeure The clause which absolves the seller or buyer from the contract due to events beyond his or her control, e.g. unavoidable export delays in producing countries due to strikes at the supplier's plant. Note.

5) Futures Contracts for the purchase and sale of commodities for delivery some time in the future in an organised exchange and subject to all the terms and condition included in the rules of that exchange.

6) Hedging Hedging is the use of future contract to insure against losses due to the effect of price fluctuations on the value of stocks of a commodity either held or to be acquired. Basically this is done by establishing a position in the futures markets opposite to one's position in the physical commodity.

3.4 Sub-Contracting

Organisations of all kinds subcontract aspects of their activity, and subcontracting is often viewed as a means of augmenting limited resources and skills while still enabling the contractor to concentrate on his or her main area of expertise in the execution of prime contract. When a contract has been awarded to a supplier (the prime contractor), the supplier frequently subcontracts some of the production work required to the job. Items purchased on subcontracts are actually purchased parts or components. However, subcontracting usually takes place when it is not possible to produce the parts in the local plant by the prime contractor. Hence subcontracting is: the work of obtaining the prime contract's (manufacturer's) requirement, mostly of fabricating parts and components, from outside sources in order to manufacturer a certain product (or execute an awarded contract) in the prime contractor's plan.

A large firm may like to concentrate its efforts on major items of the contract and leave several minor ones to small manufacturer. Thus many types of organisation subcontract security arrangement, waste or scrap disposal, plumbing and a whole range of specialist activities provided they are considered more conventional sub-contract services. The subcontractors are thus legally responsible to the prime contractor rather than the buyer or client even when the client has stipulated which subcontractors is to be used. The prime contractor's subcontracting decisions are however important to a buyer because they may involve a large percentage of prime contract money. Sub-contract price and performance influence the prices the buyer pays the prime contractor.

3.4.1 Reasons why Subcontracting has become a Major Management Activity

Three reasons have been responsible for the prominent rise of subcontracting as a major activity requiring management decision on part of both the prime contractor and the sub-contractor. These are:

(a) The rapid rate of technological inventions.

(b) The fast rate of installation of this change in products and processes.

(d) Further movement toward specialisation, which is characterising business enterprises throughout the world.

For the above reasons and others as listed Peter Bailey and David Farmer (1981:254), subcontracting is a major management activity.

(1) One major reason is insufficient financial resources to provide facilities to perform the function within the company.

(2) Lack of (production) capacity internally.

(3) Lack of time for completion of work to meet a rapidly approaching “target date”. (4) Lack of know-how because of complexities of rules and procedures to make the item in-house.

(5) Because a specialist sub-contract is more cost effective either in production or geographical location terms.

(6) Customer or buyer stipulates that work should be sub-contract, usually for a nominated firm.

3.4.2 Selecting a Sub-Contractor

Although, all issues relating to sourcing (as discussed in unit five) are relevant in the selection of a subcontractor, certain pertinent and additional issues require further detail consideration in the selection of a subcontractor. Bailey and Farmer (181) suggested a number of key questions to be asked and answered in subcontractor selection.

1) What is the company’s major specialisation? For example, are they jobbing machinists, or are they capable of working to close tolerance? For whom have they worked? How long have they worked for these companies? Can we ask these customers about their service and quality performance record?

2) They do have a permanent and well-trained labour force? What is their industrial relations record?

3) Are their quality – control procedures adequate?

4) Are their production –control procedures adequate?

5) Are they adequately financed?

6) If tooling is required, can they make the tools themselves?

7) Do they own their own transport? Is it reliable?

8) In government work, are they approved by the relevant inspectorate?

Where possible, each of these questions can be expressed in quantitative terms. Notwithstanding, the extent to such investigations depends upon the quality and importance of the work to be undertaken. To however do an effective buying job, the following necessary actions are to be taken:

(a) Continuous appraisal of subcontractors because of changes that inevitably take place in companies over time.
(b) Specification and standardisation of working should be agreed before subcontractors submit quotations particularly with new subcontractors.
(c) In higher subcontracting, close liaison between the prime contractors and the sub-contractor's staff essential.

3.4.3 The Rules of Behaviours in Subcontracting

It is a truism that two cannot walk unless they agree. This also found expression in subcontracting. Until the two organisations involved know each other well and technical requirements are fully understood, the maxim, **if in doubt –ask!** Should be adopted. It is therefore further suggested. By Peter Bailey and David Farmer that it is a good practice to:
(1) Make an individual particularly responsible for all contracts with sub-contractors.
(2) From the outset, work requirements of the sub-contractor must be clearly established.
(3) From the outset, understanding must be reached as to the quality and workmanship, which is required of the sub-contractor.
(4) Make provision for compensation for any spoilage or partially finished work by the subcontractor subject to accepted conditions of trade.
(5) It is often advantageous to supply the sub-contractor with tooling and equipment on loan, particularly if the subcontracting arrangement is temporary.
(6) Inspection arrangement needs to be clearly
(7) Procedure and documentation should also be clearly b established at the outset.
(8) The limit of the sub-contractors liability for damage to persons or property in respect of claims arising from the contract should be clearly defined.

3.5 Purchasing Service

The procurement of service is one of the purchasing most interesting and challenging assignment because large sums of money are involved. Expenditure on service in all types of organisation (e.g. profit or non-profit making organisations, government or non-governmental organisation etc) increases each year. The reasons for this are the key roles played by purchased services in the successful operation of these organisations. In many instances, the impact of the services themselves on the success of the organisation's operation is far greater than the impact of the naira spent. Service ranging from architectural engineering, promotion and advertising, and development of software, to the maintenance and repair of production equipment are of critical importance to the operations of the organisation. More mundane purchase such as cafeteria and janitorial operations impact the morale of all employees. Services which are not at all in the areas of competence of an organisation such as management information system, payroll travel services, delivery service, even the procurement of MRO supplies and service, are being outsourced to service providers. These suppliers have the expertise and economies of scale to allow them to provide the service at the same or higher quality level than the purchasing firm and at a lower total cost.

3.5.1 Selection of Service Contracts

Selecting the "right" source is much more of an art when purchasing services than when purchasing materials.

• Based on the complexity of such services procurement and the unexpected problems that tend to rise, it is normally prudent practice to select only established, reputable firms.

• When a large number of potential contractors are available, the buyer and the customer normally reduce this list to three to five firms.

• The buyer then invites proposal from only the potential suppliers with which the buying firm would be comfortable doing business. During the evaluation process, emphasis should be placed on the total cost and total benefits to the buying organisation.

• In addition to the traditional concerns about a prospective contractor's financial strength, management capability, experience, and reputation, the area of technical capabilities requires special analysis.

3.5.1.(a) The Ideal Services Supplier

The ideal service supplier listens to what users complain about most and then design service products that supply the market's missing ingredients. Satisfaction is built into service products rather than added as an afterthought. The ideal services supplier invests to increase both employee productivity and customer satisfaction. If such an "ideal" services supplier or contractors is not available, the purchasing firm should consider the development of a long-term relationship with a supplier willing and able to grow into an "ideal" provider.

3.5.1.(b) Professional Services

Architect, engineering firms, lawyers, consultants, and educational specialist are representative of the individuals and firms which provide professional service. The professional buyer pays particular attention to the relationship between the price mechanism (e.g. firm fixed price, cost plus incentive fee, fixed price with award fee, and so on) and the contractor's motivation on critical professional services contracts. Every naira that the supplier's costs are reduced results in a naira of additional profit Administratively, it may be impractical to use anything other than a fixed price contract or an hourly rate price for relatively small professional services contracts. Even on larger naira amounts, the supplier's reputation may allow the use of a fixed price contract. But buyers should be aware of the potential effect of the pricing mechanism on the contractor's performance.

3.8.1(c) Operating Services Janitorial, security landscaping, and cafeteria operations are operating services. Experience has shown that obtaining effective performance of such can be very challenging for administrators. Accordingly, the compensation scheme should reward the supplier for good and penalize it for poor service. Such an approach to pricing greatly aids in the administration of the contract and results in a higher level of customer satisfaction.

Insurance, plant and equipment maintenance, and anticipated emergency service should be priced through the use of competition of carefully prequalified supplier. Unanticipated emergency repairs normally are purchased on a "not- to exceed" time and materials basis.

4.0 CONCLISION

There is no gainsaying that purchasing has been an important aspect of management, be it business management or management of non-profit. In contemporary business operation, how well an organisation does its buying may spell the difference between profit and loss. Indeed, there is an old proverb, Goods well bought are sold. This is literally true in the purchasing function of a manufacturer, purchasing raw materials and equipment or in the purchasing function of merchant middlemen whether wholesalers or retailers. Even in the modern consumer market, particularly, for sophisticated goods, e.g. specialty goods, the purchasing function is very important; purchasing however has a wider meaning. It is more than mere buying. It is considered a managerial activity and it includes planning, organisation and control of a wide range of interrelated activities. Purchasing is very closely related to production as well as marketing departments of an organisation. All these three functional areas of business must work in cooperation to fulfill the company-wide targets.

5.0 SUMMARY

Modern advanced industrial technology rests upon the use of vast amounts of capital: elaborate machinery, large-scale factories and plants, stores and stocks of finished and unfinished materials. Capitalism got its name because this capital or productive wealth is primarily the private property of somebody – the capitalist. There is no single market for industrial goods, but several markets. Industrial buyers tend to base their selection of goods and services on objective criteria. The industrial buyer buys a vast variety of goods and services. Some goods and services are relative expensive and are generally used within a year of purchase. Those that are more expensive and have a longer useful life are considered capital items. Every purchased transaction originates with the recognition of the need for an item by someone in the enterprise. This need may originate in the department using the material.

6.0 TUTOR-MARKED ASSIGNMENT

What sense does the rules of behaviours in subcontracting make to you? Explain these rules.

7.0 REFRENCES/FURTHER READING

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UNIT 10 MANAGEMENT OF INVENTORY 103

Contents

1.0 INTRODUCTION

One of the major tasks of any management today is to control stock or inventory (These two terms-inventory and stock – shall be used interchangeably for the purpose of this book as the terms are definitionally indistinct). Both goods producing and service providing companies use materials. In majority of industries, inventories constitute the most significant part of current assets. Indeed, for many manufacturing firms materials costs account for over 50 percent of total production costs. To neglect effective and efficient management and control of inventories is to jeopardize a business Lon run profitability and survival (Ishola, T. O; 2002, P. 263). Stocks are defined by the Chartered Institute of Management Accountants as; Goods or inventory held comprising:

• Goods or other assets purchased for resale;
• Consumable stores;
• Raw materials and components purchased for resale incorporation into products for resale;
• Products and services in intermediate stage of completion (work-in-progress);
• Long-term contract balances; and
• Finished goods.

Similarly, inventory is an American accounting term for the value or quantity of raw materials, components, assemblies, consumables, work-in-progress and finished stock that are kept or stored for use as the need arises.

The term also applies to; (1) A detailed list of goods or articles in a given place or (2) A stocktaking. Thus in an organisation, Inventory refers to the storage in storehouse or warehouse of products manufactured for sale and components that make up the product. Inventory relates to only materials or goods; services are excluded. Inventory (or stock) control in this context therefore, refers to 'the techniques used to ensure that stocks of raw materials or other supplies, work-in-progress and finished goods are kept at minimum levels of cost'.

2.0 OBJECTIVES

At the end of this studying unit, you should be able to:

• highlight various classifications of inventory and the reasons for holding inventory
• explain the economic principles behind stock control
• state and describe different approaches to stock control

• comment on the problem associated with the EOQ model.

3.0 MAIN CONTENT

3.1 Inventory Classifications

Much as the various functions of stores management has been identified with the receipt, preservation different types of inventories or stocks or materials maintained in a business organization can also be identified. All businesses use the same general classification of inventories, including raw materials, purchased parts, work-in-progress, finished good and supplies.

1) Raw Material

A raw material inventory includes all items that being received at the plant require additional processing before becoming an identifiable part of the finished product.

2) Purchased Parts

This classification of inventory is applied to component parts of a product that need no additional processing before being assembled into the finished product.

3) Work-in-Progress

This classification of inventory is self-explanatory. All material that leaves either raw materials store or purchased parts stores enter the work-in-process inventory until the product is completed and placed in finished goods.

4) Finished Goods

Again, this is self-explanatory – it is the stock of finished or completely manufactured goods/products which are ready for sale. Generally speaking, this classification applies to the quantities of finished goods that are held at the factory awaiting shipment.

5) Supplies

All the materials needed for the operation of the firm that are not used as parts of the finished product are classified as supplies. Cost accounting commonly identifies this stock classification as ‘indirect material’. On the other hand, the material that becomes parts of the finished product is called ‘direct material’.

3.2 Reasons for Holding Inventory

The question of managing and controlling inventories or stocks arise only when the company holds inventories. Maintaining stocks arises only when the company holds inventories. Maintaining inventories involves typing up of the company's funds. Unintentional excess buying and overstocking inevitably result in unprofitable investment, high inventory holding or carry charge (e.g, storage and deterioration expensive) and possible losses caused by price declines. If it is so expensive to maintain inventories, why do companies then hold stocks? There are three general motives for holding inventories or stocks. These are: 1) The transaction motive which emphasizes the need to maintain inventories to facilitate smooth production and sales operation on basis.

2) The precautionary motive explains the need for inventories to guard against the risk of unpredictable changes in demand and supply forces and other factors 3) The speculative motive influences a firm's decision to increase or reduce stock levels to take advantage of price fluctuations. In more specific terms, the following additional reasons have been severally advanced as reasons for holding inventory: (a) To avoid the loss of customers that occurs when product is not stocked. (b) To meet sudden spur in customer demand (c) To keep the firm from cutting back or shutting down briefly due to material shortages, depletion or exhaustion.
(d) To capitalize on discount in the price of raw materials.
(e) To protect against strikes
(f) To manufacture product in quantities that minimize cost.

3.3 The Objectives of Stock Control

Objectives are the desired end-results. The ultimate objective of all manufacturing controls is to realise a profit through the operation of the business. A more restricted objective of the control of materials is to satisfy the customer by meeting the schedule for deliveries. Failure to deliver customers' orders on time is one principal cause for the loss of business and customers. Effective control of materials throughout the manufacturing cycle prevents this problem from arising.
The following additional objectives or aims of inventory control are classical to mention:
(1) To provide both internal and external customers with the required service levels in terms of quantity and order rate fill.

(2) To ascertain present and future requirements for all types of inventory to avoid overstocking while avoiding bottlenecks in production.

(3) To keep costs to a minimum by variety reduction.

(4) To improve the quality of manufactured goods by the use of better raw materials or components.

(5) To ensure co-operation among all departments of the enterprise to meet materials management objectives.

3.4 The Economics of Stock Control

Inventory or stock constitutes an investment, which must be controlled. Firms are however commonly faced with the problem of meeting conflicting needs in the context of inventory management. These are:

(1) To maintain a large size of inventory for efficient and smooth production and sales operations.

(2) To main a minimum investment in stocks to maximise profitability. Business firms should always avoid over-investment or under-investment in stocks or inventories. There are basic costs incurred by any organisation, which holds stocks. The economics to stock management and control can therefore be determined by an analysis of the costs incurred in obtaining or acquiring and carrying inventories. Lyson, k (2000:222) presented the procedures for such costs analysis under the following headings:

3.4.1 Acquisition Costs

Many of the costs incurred in placing an order are incurred irrespective of the order size, e.g. the cost of an order will be the same irrespective of whether 1 or 1000 tons are ordered. Ordering costs including: (1) Preliminary costs, e.g. preparing the requisition, vendor selection, and negotiation. (2) Placement costs, e.g. order preparation, stationery, postage, etc. (3) Post-placement costs e.g. progressing, receipt of goods.

3.4.2 Holding Costs

These costs relate primarily to the consequences of over-investment in inventories or excessive stocks, and these are of two types:

(A) Costs proportional to the Value of Inventory, e.g. (1) Financial costs, e.g. interest on capital tied up in stock or inventory. This may be bank rate or, more realistically, the target return on capital required by the enterprise. (2) Costs of insurance (3) Losses in value through deterioration, obsolescence and pilferage.

(B) Costs Proportional to the Physical Characteristic of Inventory. These include: (1) Storage costs, e.g. storage space, stores rate, light, heat and power. (2) Labour costs relating to handling and inspection. (3) Clerical costs relating to stores records and documentation.

The total costs per annum under each heading will be expressed as a percentage of the monetary value or quantity of the average stock held.

3.4.3 Costs of Stock Outs

These are costs incurred for under-investment in inventory resulting in inadequate stocks of materials. These comprise: 1) Loss of production output. 2) Costs of idle time and of fixed overheads spread over a reduced output. 3) Costs of action taken to deal with the stock out, e.g panicky buying at an uneconomical price for lack of time for proper negotiation, switching production, obtaining substitute materials. 4) Loss of customer goodwill through the inability to supply or late delivery. 5) Opportunity cost like forgone quantity discount. Often costs of stock outs are hidden in overhead costs. Costs of stock outs are difficult to estimate or incorporate into inventory models.

3.5 Approaches to Stock Control

As previously noted in the sub-section 3.3 discussion, the objective of inventory or stock control should be the avoidance of excessive and inadequate levels of inventories and the maintenance of sufficient stock to ensure operational smoothness. Although there are many systems for the control of stock, both manual and automatic, there are really only two basic approaches on which these stock control systems are based. Re-ordering of supplies will either take place: (1) When stocks fall to a predetermined level, or (2) According to the situation discovered when physical stock levels are reviewed on a periodic regular basis. Sometimes, these approaches will be used in combination. For example, it might be the case that the reorder level approach is employed with the backup of periodic regular review of physical stock levels. The two approaches are commonly called the “action level” method and the “period review” approach. Emphasis shall however be on the former for the purpose of this book.

3.5.1 The Action Level Method

The basic method of controlling stock by quantity is by means of fixed, for each commodity, stock levels that are recorded in the stock control system (usually the perpetual inventory record) and subsequently used as a means of indicating when some action is necessary. There are various kinds of stock levels, but the fundamental controls are;

1) Maximum

2) Minimum

3) Re-order

4) Hastening

5) The Economic Order Quantity (EOQ)

It does not follow that all these are necessary or even desirable for every material items, and they should be employed with discretion, because the fixing of too many levels make the work of provisioning unduly complicated.

1) The Maximum Stock Level

This is the level calculated representing the maximum stock that should be held in store in order to minimise the costs of over-stocking.

Only under abnormal circumstances should management authorize purchases above this uppermost limit.

In determining the maximum stock level, consideration is given to a number of factors like;

1) The rate of materials consumption,

2) Availability of storage space,

3) Risk of deterioration, obsolescence, and / or evaporation,

4) Economic conditions like price stability and availability of materials from suppliers.

There is no general consensus about the method for calculating this stock level but it may be expressed as:

Maximum stock = Recorder level +Recorder quantity = Minimum usage during reorder period.

2) The Minimum Stock Level

This is the lowest level below which stock should not be normally allowed to fall if the firm is not to risk the consequence of inadequate inventory or stock outs. It is the minimum reserve or buffer stock, which comes in handy during emergencies.

The factors affecting the minimum stock level include:

1) The rate of consumption

2) The lead or re-procurement time.

The lead-time is the period of time between placing order or raising requisition (internally or externally) and materials delivery i.e. when goods are made available for use.

It is expressed as a mathematical formula as follows:

Minimum Level = Demand x delivery period

(100 per week) x (6 weeks) = (600)

Min Level = 600.

3) Re-order Level

This is point at which it is essential to initiate purchase requisition. It is a point in betweens the maximum and minimum stock levels. It is the quantity of stock necessary to protect against the exhaustion of the stock during the gap between the date of order and the date of delivery. When the level of stocks or the balance on hand reaches this level, it is an indication that a new order must be placed at once.

The reorder level is affected by factors like: 1) Material consumption rate 2) Minimum level

3) Lead time and risk factors like variations due to uncertainty.

As a formula, it is expressed as follows: Reorder Level = Minimum stock + 25 per cent buffer stock.

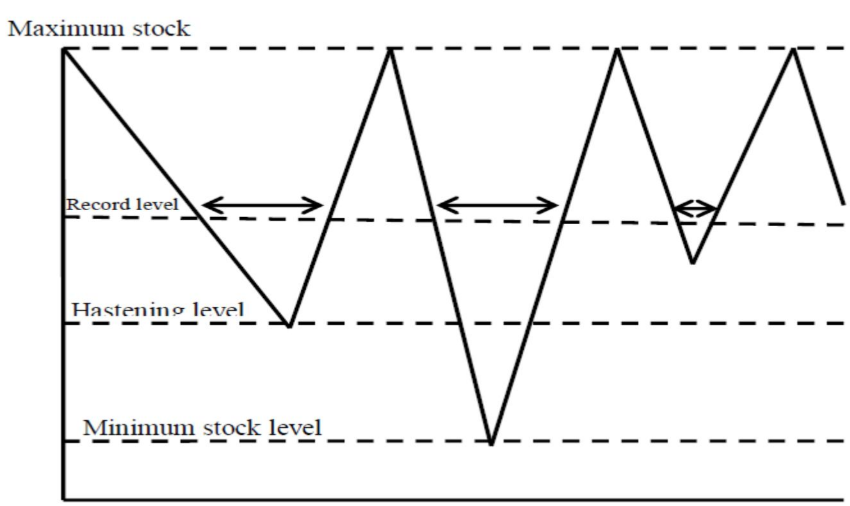
Because of the risk involved in telling on prompt deliveries, a figure for extra or buffer stock (often 25 per cent of minimum stock) is added to the minimum stock. Applying the above formula therefore, we have;

Minimum stock = (600) + 25 per cent buffer stock

= (600) + (150) = (750) ► Reorder level = 750.

4) The Hastening Stock Level

This is the amount expressed in units of issue at which it is estimated that hastening action is necessary to request suppliers to make early delivery. It is fixed between the minimum and the reorder stock levels. These stock levels are graphically illustrated in figure 9.1 below.



Time (days/weeks/months

⟷ = Lead time Constant ordering quality

Figure 4.1: An action level approach to stock control

The point that must be stressed is that, in order to keep abreast of changing market (environmental) conditions, after stock levels have been established in the first instance, they should be carefully reviewed at suitable intervals e.g. quarterly, monthly, or even weekly, and adjusted to meet changes in the prevailing circumstance. Unless this is done, the levels originally fixed soon become out-dated and system of stock control is rendered ineffective.

3.5.2 Inventory (Stock) Control Models

As a concept, a model is a simplified representation of reality. It is a pattern for solving problems and consists of set of interrelated variables that represent some realities (either of a system, process, or outcome) as closely as possible. A model is used to answer such questions as what if, and which is best? Given this conceptual framework, therefore, Inventory control model deals primarily with the problems of "how often" to order more raw materials and "how much" to order, "How many" goods to produce during a period to keep the finished goods inventory at the right level.

BUT WHAT LEVELS ARE RIGHT?

Among the most useful techniques for determining how much to order is the economic order quantity (EOQ); that is the level that balances two different kinds of inventory costs-holding (or carrying) costs and ordering (or acquisition) costs. The EOQ is simply the stock level that mimeses the total of ordering and carrying costs (please refer to the 9.4.1 and 9.4.2 for the detailed discussions of these two costs.)
An easy way to determine EOQ is to use the order formula approach even though it can also be found out graphically. Hence, the EOQ of an item can be expressed in more detailed terms using the formula below:

$$EOQ = \sqrt{\frac{2\,DC}{CI}}$$

Where: D => Demand or annual usage

O => Ordering cost or acquisition cost

C => Carrying cost or holding cost

To be able to calculate a basic EOQ, certain assumptions are necessary. These includes:

i) That there is a known constant stock-carrying cost.

ii) That there is a known, constant ordering cost.

iii) That the rates of demand are known.

iv) That there is a known, stable price unit

v) That the whole ordered batch is delivered at once without any limitation imposed by stores capacity.

The EOQ formula can be derived or obtained using differential calculus as illustrated in the following section.

1) ORDERING COSTS

The number of orders placed each year is:

$$\text{Annual Usage in units} \qquad = \frac{a}{q}$$

Order quantity

The ordering costs are costs of placing an order x number of orders =

$$c \text{ x } \frac{a.}{q.} = \frac{ac}{q}$$

2) HOLDING COSTS

$$\text{The average stock level is half the order quantity} = \frac{q}{2}$$

The holding costs are average stock level x holding

$$\frac{q.}{2} \text{xh} = \frac{hq}{2}$$

(3) TOTAL COST Total cost =holding costs + ordering costs

$$\overline{T} = \frac{Hq}{2} + \frac{ac}{q}$$

(4) MINIMUM COST T will be maximized or minimized when

$$\frac{dT}{dq} \qquad = O$$

$$\frac{dT}{dq} \qquad = \frac{h}{2} - \frac{ac}{q^2}$$

$$\frac{dT}{dT} \qquad = O = \frac{h}{2} - \frac{ac}{q^2} = O \quad hq^2$$

$$\text{On cross multiplying} \quad = \quad q^2 \qquad \frac{2\,ac}{h} =$$

$$= q2. \quad = \frac{2\,ac}{h}$$

NOTE: (Since q cannot be negative only the positive square root is used.) Thus the total cost is a minimum when:

$$\mathbf{EOQ} = q = \sqrt{\frac{2\,ac}{h}}$$

The formula may be clarified by means of a simple illustration, in which the following facts are assumed:

q. = Order quantity in unit

a. = Annual usage in unit

c. = Acquisition cost per order

p. = Price per unit h. = Holding cost per unit Note: h is the actual cost of holding one unit for one year. In examination questions, the holding cost is sometimes given as a percentage of the price of a unit.

EXAMPLE 1

If the holding cost is 5% and the price of a unit is N 140.oo then

$$h. \quad = \quad \frac{₦140 \text{ x } 5}{100} ₦\ 7.00$$

EXAMPLE 2 To check that the formula works let's apply it to this problem in which a= 8,000; c = 25, h = 2.50. Hence:

$$\text{EOQ} = q = \sqrt{\frac{2\,ac}{h}}$$

$$= \sqrt{\frac{2. \text{x } 25 \text{ x } 8000}{2.50}}$$

$$= \sqrt{\frac{400{,}000}{2.50}} = 160{,}000$$

EOQ => 400 Units.

EXAMPLE 3 A manufacturing company has an expected usage of N50,000 units of certain product during the next year. The cost of processing an order is N20 and the carrying cost per unit is N 0.50 for one year.

Lead-time on an order is five days and the company will keep a re-service supply of two days usage.

You are required to calculate: (a) The economic order quantity, and

(b) The re-order point (Assume 250 – day year)

SOLUTION

(a) The economic order quantity is

$$\mathbf{EOQ} = q = \sqrt{\frac{2\,ac}{h}}$$

$$= \sqrt{\frac{2x20x50{,}000}{0.5}}$$

$$= \sqrt{4{,}000{,}000}$$

$$q. \quad = \quad 2{,}000 \text{ units}$$

(b) The re-order point is

Daily usage = 50,000 / 250 = 200 units

Re-order point = Safety stock + lead time X Usage

= 2(200) + 5 (200)

= 400 + 1,000

= 1,400

3.5.3 Problems Associated With EOQ Based System

There are a number of problems that the inventory (or stock) controller must bear in mind when employing the EOQ method of stock control. These are as follows:

(a) Accurately establishing the true cost of ordering and setting a standard to cover every type of order.

(b) Establishing true storage costs, given that many organisations have a very wide range of stock, each requiring different forms of handling and storage

(c) How to cope with unexpected alteration in the pattern of demand for stock.

(d) How to cope with variations in lead-time, even though deliveries may be set at regular intervals, delays can still occur.

SELF ASSESSMENT EXERCISE

Select a manufacturing company and list out the various forms stocks are held.

4.0 CONCLUSION

Both excessive and inadequate stocks are not desirable. In the past, managers of manufacturing concerns assumed that accumulation of adequate stocks were beneficial and therefore do not feel the necessity for controlling.

A number of factors have however helped to change this traditional outlook. Firstly, the modern industrial economy put greater pressure for maintenance of adequate liquidity on firms. Secondly, the wide variety and complexity of requirements of modern industry necessitates a conscious improvement in inventory control.

Today, stock management and controls is a commanding concern in modern business because of the grave implications of poor control over stocks. Business firms should always avoid over-investment or under-investment in stocks or inventories. There are basic costs incurred by any organisation, which holds stocks.

5.0 SUMMARY

Because the stock held by any organisation represents money, the control of that stock has serious financial implications on the company. If the stock is inefficiently controlled, it can cause high storage costs, obsolescence, and a reduction in working capital. Therefore stock control is very much concerned with ensuring that stock is controlled very carefully. In many situations, the actual level of profit earned by an organisation will depend on the success of stock control. Both goods producing and service providing companies use materials. In majority of industries, inventories constitute the most significant part of current assets. Indeed, for many manufacturing firms, materials costs account for over 50 percent of total production costs

6.0 TUTOR-MARKED ASSIGNMENT

How is the economics of stock control determined?

7.0 REFERENCES/FURHER READING

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UNIT 11 NEGOTIATED PROCUREMENTS ----------------------116

Content

1.0 INTRODUCTION

The most flexible, but sometimes complicated, means of procuring goods and services is negotiation. This method is used when contracting offices: 1) cannot define all the requirements of a procurement, or 2) when factors other than price are important enough to require evaluation. Negotiation procurements take many forms. They may call for competitive proposals, may involve restricted competition, or may even be sole source. Some permit discussion with of errors, while others allow award of a contract without discussion

2.0 OBJECTIVES

At the end of this studying this unit, you should be able to:

- define the term Negotiation and clearly states its objectives
- comment on time Negotiation is most appropriate and Highlight the requisite position and qualifications of the Negotiator
- list and Explain the steps involved in the Negotiation process
- identify and describe the various Negotiation Postures.

3.0 MAIN CONTENT

3.1 What is Negotiation?

Regardless of the size of the purchasing department or the volume of purchases, negotiations have to be conducted in every type of industry or business engaged in the function of procurement, whether it is of services or of materials.

It is generally accepted that the ability to negotiate is a key competence in a purchasing executive. In industry, and most levels of government, the term negotiation frequently causes misunderstanding. Depending on the level of perception and/or objective:

(1) some may consider negotiation as a form of **horse-trading** (arguments about something e.g. prices); or hassling and

(2) sometimes, it is confused with **price chiseling** (that is obtaining price deceitfully).

But negotiation is neither haggling nor bargaining. The dictionary defines negotiation as a: “Mutual discussion and arrangement of the term of a transaction or agreement”. OR simply; confer with others in order to reach a compromise or agreement” Another expert opinion descried negotiation as, ‘The process by which we search for terms to obtain what we want from somebody who wants something from us.’

This particular definition more importantly revealed that negotiation implies some mutuality of wants, resolved by exchange. Purchasing and supply is certainly concerned with exchanging for value, and with finding new ways of doing business. However, defined, negotiation is more usefully seen as a process whereby agreement is sought. Professional negotiation is thus a means by which two parties reach an agreement by a specialised process of communication techniques and arrives at a mutually satisfactory settlement, resulting in a balancing of the interests of the parties. Indeed, the following facts must be established about negotiation in purchasing.

5) Negotiations may involve dealing with a single issue or many
6) They may also be conducted on a one-to-one basis or between teams of negotiators representing different interests, and
7) May be conducted over a telephone in a matter of minutes, or take many months to complete.
8) It can be for the purpose of setting the price of materials or it can relate to finalizing various terms and conditions such as specifications, delivery packaging, insurance and so on.

The most import ingredient in the art of negotiation is communication. Therefore the essential techniques in negotiation are those, which are employed in the communication of ideas. Since negotiation involves convincing the other party of your point of view and reaching an agreement, communication skills, prove useful. It does not involve any science or mathematical formula. It is an art. Contracting officers use negotiated procurements whenever sealed bidding is not appropriate. Generally, negotiation is appropriate:

a) if item does not permit sealed bidding,
b) if award will be based on factors other than just price,
c) if discussions are necessary, or
d) if the Government is only aware of one source.

David Jones et al (1994:165) argued that there are alternative ways of reaching agreement that do not involve negotiations and can be appropriate and effective in the right circumstances. Some of these alternatives to negotiation are:

1) *Persuade*: This involves encouraging the other party to accept the merits of a particular case with no concessions from yourself.

2) *Give In*: That is, accepting totally what the other side offers.

3) *Coerce:* This is an insistence that the other side meets your demands or else.

4) *Problem Solve*: This alternative removes the difference between the parties so that there is no need to negotiate.

3.1.1 Objectives of Negotiation

Generally speaking, the objective of negotiation is agreement. In other words, it is to persuade and convince the other side with your viewpoint and it must not be used to win an argument but to reach an agreement. This is one major difference between negotiations and a ball game or a war. Those activities, only one side can win; the other side must lose. In successful negotiation, both sides win something. Popular usage calls this approach, **win-win negotiation**.

Several objectives are common to all procurement/sales negotiations:

1) To obtain the quality specified.

2) To obtain fair and reasonable price.

3) To get the supplier to perform the contract on time.

In addition, the following objectives must be met:

a) To exert some control over the manner in which the contract is performed.

b) To persuade the supplier to give maximum cooperation to the buyer's company.

c) To develop a sound and continuing relationship with competent suppliers.

d) To create long-term partnership with a highly qualified supplier.

3.1.2 When to Negotiate

In most cases purchasing orders are concluded on the basis of quotations received. Negotiations with the vendor will quite often follow after he has submitted his quotation, but sometimes negotiations take place as the first step in the purchasing deal. Negotiation is required when changes in the scope of a contract, call for changes in initial pricing and terms and conditions. Menon K.S. (1993:142) listed the following instances when the buyer and seller may consider negotiating:

1) Variations in the quality being purchased.

2) Changes in drawings and specifications.

3) Change in transportation, packaging or delivery point.

4) When supplies or services can be obtained from only one source. That it when competitive bidding is impractical

5) When no acceptable quotations are received from the responding vendors.

6) Price or other items and conditions of the contract, relating to large volumes of a large value, especially of scarce commodities where the contract relates to a long period.

7) When it is not practicable to draw up detailed specification and descriptions for certain service or supplies and these are required to be orally explained or clarified.

3.1.3 The Negotiator's Position and Qualifications

Purchasing executive and salesmen are individuals usually acting as representative of the various organisations that employ them. Their behaviour in negotiation will be influenced:

(i) by their personal characteristics,

(ii) which in turn will be partly determined by their roles, and

(iii) the situation in which they are negotiating.

3.1.3 (a) The Negotiator as a Representative

In negotiation, it is important for a buyer to know the extent of his authority to commit the organisation he is representing, since such authority prescribes his options and his responsibility for the outcome of the negotiation. The degree of authority he has as a negotiator may range from that of:

1) An emissary commissioned to present without variations, a position determined by his superior,

2) To that of being a free agent. And as a free agent, he can negotiate freely and even vary the stand taken by his company depending on the situation at the negotiation table. It is however recommended that the complex can open the negotiations, the greater should be the status of the negotiator(s).

There are five conditions that prevent a negotiator from responding spontaneously to his opposite number:

i) When a negotiator has little in determining his position.

ii) When he is held accountable for his performance.

iii) When he has sole responsibility for the outcome of the negotiation.

iv) When he is obligated to a constituency that is present during the negotiations.

v) When he is appointed rather than elected. In the above situations, a negotiator's behaviour is constrained by his obligations.

3.1.3 (b) Personal Characteristic of the Negotiator

The fewer the constraints imposed in a negotiator such as knowledge, experience and personality the wider the scope of his ability to influence the negotiation process. Studies have shown that personality variables such as anxiety, dogmatism, risk-avoidance, self-esteem and suspiciousness affect the degree of cooperation or competitiveness present in a negotiation situation.

3.2 The Process of Negotiation

In the broadest sense, negotiation begins with the origin of a firm's requirement for specific materials or services. According to Donald Dobler and David Burt (1996:363), actual two-party negotiation begins with a buyer's requests for proposals from potential suppliers. It develops as the negotiator carefully evaluates these proposals and prepares for discussion of the important issues that may arise in the impending negotiation conference. The negotiation process ends with the resolution of all issues that actually do arise during the negotiation conference. It is therefore useful to consider negotiation conceptually as a three-phase process.

• The first of the phases is the preparatory stage.

• The establishment of objective is the second stage.

• While face-to-face discussions, which result in agreement on all items and conditions of a contract or a decision not to enter into an agreement with the potential supplier is the third phase.

3.2.1 Preparation for Negotiation

It is arguable that over 90 percent of the time involved in a successful negotiation is spent in preparing for the actual face-to-face discussions. David Jones et al (1996:169) provided a list of key considerations as identified by Kennedy in the preparation for negotiation. This includes:

1) What do we want? Such want may for example include:

a) A lower price

b) An improved relationship

c) A bigger discount

d) Faster delivery

e) Changes in quality.

The range of negotiable variables in most buyer-seller relationships or transactions is very wide.

2) How valuable is each of our wants to us? Perhaps, for example:

a) Prompt delivery = high priority;

b) Lower price = medium priority; and

c) Quality changes = low priority.

3) What are my entry and exit point? As a negotiator, your point is really your opening bid. Once disclosed, you are unlikely to better it, so the bid obviously requires careful thought. The exit point is your walk away position. It is important that these facts be identified and understood at the preparatory phase. If only remove the possibility of striking an agreement, which may be regretted later. In addition, Dobler and Burt suggested that the negotiator must:

1) Know the item or service.

2) Know the seller's Bargaining Strength The seller's bargaining strength usually depends on three basic factors:

a) how badly the seller wants the contract;

b) how certain he or she feels of getting it, and

c) how much time is available to reach an agreement on suitable terms.

The buyer should encounter no difficulty in determining how urgently a seller wants a contract. The frequency with which the sales person calls, and general market conditions are positive indicators of sellers' interest.

3) Know the Buyer's bargaining strength. The buyer's bargaining strength depends on three basic factors:

a) The extent of competition present among potential suppliers

b) The adequacy of cost or price analysis; and

c) The thoroughness with which the buyer and all other members of the buying team have prepared for the negotiation.

4) Know the adequacy of cost or price analysis.

5) Know the Seller. 6) Know the thoroughness of buyer and negotiating team preparation.

3.2.2 Establishing Objectives

Meaningful objectives are essential to successful negotiating but rarely are such negotiation objectives meaningfully and clearly defined. Negotiation objectives must be specific. General objectives lower than previous prices; good delivery etc, are inadequate. For each term and condition to be negotiated, the negotiating team should develop three specific positions:

1) An objective position;

2) A minimum position, and

3) A maximum position.

The objective position for instance, is the negotiator's best estimate of what he or she expects to strike as an agreement. It can be very helpful to write down the agreed objectives(s) for the coming negotiation. Writing them down will serve to ensure that those involved know;

1) What is to be achieved; and

2) Upon what assumptions those objectives have been based.

It is important to recognise that the objectives, which are set, will be based upon an assessment of the situation within the given existing information. If some of the information proves to be faulty, then it may be necessary to change the stated objectives and probably the methods by which they are to be achieved.

3.2.3 The Actual Negotiation

The actual negotiation involves a four phase face-to-face negotiations and specifically the processes include:

1) Fact Finding

During the initial meeting with the potential supplier, the professional negotiator and the negotiating team limit discussions to face-finding. The important consideration is that during the face-finding session, the buyer and the supplier should attempt to analyse each other's point of view. The buying and selling representatives should disclose their interests – not their positions.

2) The Recess

While it may not be necessary to call for a recess in negotiation relative to small procurement, in major negotiations, it would be good strategy to call for recess after the face-finding session, to enable both teams to evaluate the facts and analyse the issues, assess the negotiating ability of the opposite team and, if needed, revise the issues. The duration of the recess depends on the circumstance and the issues involved.

3) Narrowing the Difference

When the formal negotiations reconvene, the negotiator defines each issue, states the facts, and attempts to convince the supplier's representatives(s) that the negotiator moves on to the next issue. During this phase of the negotiating process, problem solving and compromise are used to find creative solutions where both parties win. If a satisfactory agreement cannot be reached, the negotiating team has the choice of adjourning (an attractive alternative for buyer if another supplier is in the wings) or moving on to hard bargaining.

4) Hard Bargaining

Hard bargaining session is the last resort and this involves the use of take – it – or – leave – it tactics. Its use is limited to one –time or adversarial situation where long-term collaborative relationships are not objective.

3.2.4 The Post-Negotiation Phase

The primary activity of the post-negotiation phase is implementation. Successful negotiation is complete until what has been agreed is implemented. Only very ordinary or value free negotiators will pay insufficient attention to his aspect of the work. An effective negotiator would therefore need to take a number of necessary actions.

Firstly, skilled negotiators need to confirm with other party a clear understanding of what has been agreed.

Secondly, they also specify who is to do what, and by when, not only as between them and other party but also in their organization.

David Jones et al in their model of negotiation process provided the following prescriptive guidelines for the post – negotiation phase:

1) Produce the first draft agreement. This involves reporting in your own version what has been agreed, developing such agreement and sending your draft to the party for his comments and agreement

2) Ensure the commitment of people in your organisation to making the agreement work

3) Prepare official contract in line with the agreement

4) Remember no negotiation is successful until what has been negotiated is done.

5) Find time to evaluate performance, first, in negotiation, and secondly in, implementation.

Implementation of successful negotiation has the consequence of positively influencing the behaviour of both parties in future negotiations especially where purchasing transaction involves long-standing partners in the supply and demand market.

3.3 Negotiation Postures

Negotiators must be skilled at watching for, understanding and interpreting body language. No matter what people say, how they really feel can often be picked up from their body positions and gestures during the negotiations. You may consider that the other party is being honest and open, but this may not be true. You may equally feel the other side is happy; this also may not be the case. Therefore as a negotiator, you must watch for the body language.

A number of postures and what they might indicate have been provided by David Jones et al (1996 pp. 180) as shown in table 1 below:

Posture	Possible Meaning
Leaning forward when making A point	Interested; wants to emphasize a point
Avoiding eye contact telling	May be embarrassed; not The truth
Arms folded. Body turned away From you	Defensive; no compromise Not interested.
Body turned toward you leaning your Forward.	Interested; Warning toward Comments
Looking away to watch or at a further Window	Wants to leave or avoid any discussion
Hands supporting head and Leaning back in chair	confidence
Stroking nose regular with a Finger-avoid eye contact	May be lying.
Good eye contact. Fingers stroking saying Face.	Interested in what you are

Table 11.1 The Interpretation of Postures.

A negotiator should however interpret body language with sufficient caution. He/she may indeed be wrong. Nevertheless, it is a quality, that over a period of time, an experienced negotiator gets to understand the body language of the other side; this can greatly contribute to effectiveness at negotiation conference.

SELF ASSESSMENT EXERCISE

What would you regard as the conceptual facts about negotiation?

4.0 CONCLUSION

The objective of negotiation, it must be emphasized is agreement. Even though agreement is the fundamental goals of negotiation, negotiations occasionally end without agreement. In the short run, reaching no agreement is sometimes better than reaching an unsatisfactory agreement. By its nature, negotiation is a complex, fascinating subject, since it involves people, contains many variables. Generally speaking, however, experienced negotiators seldom let negotiations break down completely.

5.0 SUMMARY

However, defined, negotiation is more usefully seen as a process whereby agreement is sought. The most important ingredient in the art of negotiation is communication. Therefore the essential techniques in negotiation are those, which are employed in the communication of ideas. Since negotiation involves convincing the other party of your point of view and reaching an agreement, communication skills prove useful. It does not involve any science or mathematical formula. It is an art. In most cases purchasing orders are concluded on the basis of quotations received. Negotiations with the vendor will quite often follow after he has submitted his quotation, but sometimes negotiations take place as the first step in the purchase ideal. Negotiation is required when changes in the scope of a contract, call for changes in initial pricing and terms and condition.

6.0 TUTOR-MARKED ASSIGNMENT

Highlight in clear order the schematic process of negotiation.

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UNIT 12: EXPEDITING OR FOLLOW-UP OF ORDER ----------126

Contents

1.0 INTRODUCTION

In order to achieve the purchasing aim of obtaining delivery on time, expediting is frequently undertaken. A dictionary definition of expedite is: assist the progress of something. In manufacturing industry, this activity may be undertaken in connection with the progress of a customer's order to the point of dispatch (this is internal expediting), or liaising with suppliers to ensure that materials are received from them or as scheduled (this is external expediting). In organisations providing a service rather than manufacturing anything, most of the expediting will be internal, and in manufacturing companies, it is the external expediting, which involves the purchasing function. Following-up the order to ensure prompt deliveries is an important function and this function is also variously called, progressing, expediting or follow-up.

2.0 OBJECTIVES

At the end of studying this unit, you should be able to:

• describe the nature of expediting work
• explain the expediting process
• state the characteristic of a good expeditor
• discuss the various methods of organization for expediting activity
• list the advantages of the expediting function.

3.0 MAIN CONTENT

3.1 The Nature of Expediting Work

Expediting is a planned, proactive task. As a concept, expediting is a purchasing responsibility/task of attempting to speed up delivery as the buyer's timing requirements undergo unexpected changes. More concisely, to expedite (a term that is used rather loosely in industry) involves actions to achieve an earlier delivery than originally planned. To de-expedite is indeed the opposite and this is to attempt to delay delivery beyond the original schedule delivery time. Expression such as hastening, progress chasing, and urging are sometimes used to describe the process of attempting to ensure that delayed supply of materials does not cause problems for the buying organisation. These expressions often indicate that process is seen as a reactive one, where a problem of lateness arises, and work then begins to try to save the situation. Ideally, the relationship between the selling and buying organisations is one of mutual trust and respect, and liaison, rather than expediting.

3.1.1 Elements of Expediting

The following elements are involved in expediting work i.e., the specific issues inherent in the follow-up job:

1) First, it is necessary to secure an acceptance of the purchase order by the supplier so also a promise of delivery
2) A proper record must be kept of due delivery dates and these records must be updated as and when deliveries arrive.
3) A review should be made of outstanding orders at regular intervals.
4) Communication should be made with suppliers as and when required. This can be through e-mail, telex message, phone calls, personal visits, etc.

3.2 Expediting Procedures

One very important matter relating to expediting is that all suppliers should be given strict instructions to inform the buying company as soon as some trouble is noticed about fulfilling delivery dates. If the suppliers can be trusted to do this, expediting becomes easier. Menon K.S. (1993:162) presented a simple procedure, which can be followed as follows:

1) Two copies of the purchase order are sent to the supplier and one copy to the expeditor.

2) The expeditor files the purchase order, vendor-wise, in a current file. This file is checked every week.

3) If the acknowledgement copy has not been received back within ten days, the expeditor should do the following:

(a) He should check back with the buyer if there has been any development in regard to the order; (for example, the supplier may have written that the term of agreement requires revision).

(b) If nothing has been heard from the supplier, he should send him a routine reminder.

(c) If within a week after the first reminder no acknowledgement has arrived, a letter should be sent, preferably by name to the official concerned in the supplier's company. If this fails, a telegram and a telephone call respectively should be the means of communication.

(d) Though the supplier has not formally accepted the order, he may have started supplies. In law, this is a proof of acceptance. The expeditor should check with the stores on this matter.

4) The expeditor will consult the file every week and take such action as is necessary for follow up.

5) When a delivery has been effected, the receipt section will send him a copy of the materials receipt note. The expeditor will make the relevant entries in the order copy. As soon as the order has been fulfilled, the copy of the order is removed from the file.

Follow-up procedures may be more elaborate than the one described above, but the basic elements are the same. Another point that must be made is that progressing activities does not commence until a reasonable period of time has elapsed; constant progressing can become counter-productive and results in sour supplier relationships. Figure 16.1 below shows a typical progressing format, indicating that progressing does not commence until a reasonable period of time has elapsed.

Date of Order	Jan Feb Mar June July Aug Sept
1st Jan	——— Estimated completion period ———→
Item A	———→ Progress 1 ———→ 2 ———→

Figure 4.1: Progressing Format

3.3 Characteristic of Good Expeditor

The work of an expeditor calls for considerable foresight, good judgment, initiative and intelligence to ensure that the right degree of attention is given to the various types of orders. A good expeditor must therefore have the following characteristics.

1) An expeditor must be a good communicator. An expeditor must be skilled at transferring information in a language that can be easily understood.

2) An efficient expeditor must be resourceful.

3) An expeditor must be a progressive individual, in other words, he must be capable of gingering up and building up pressure on the supplier.

4) Time consciousness and alertness is another characteristic. A good expeditor will know when to take strong action and how.

Expediting is not a routine function carried out by clerks. A supplier does not often have the courage to be honest and gives reports which do not commit him but which can be interpreted as encouraging by a buyer. A clever expeditor can see through such reports and distinguish the genuine from the misleading report.

3.4 Organisation for the Expediting Activity

There are various methods for organising for the follow-up activity. Indeed, there is a wide difference of opinions concerning the most effective arrangement for handling the expediting activity. Some firms require each buyer to do his/her own expediting. 1) Because of the buyer's status and intimate knowledge of the order, these firms believe that a buyer can obtain more effective results from suppliers than can someone of lesser status in the organisation. 2) More important reason is that many companies using this approach want the buyer to assume total responsibility for each of his or her orders. They feel that the buyer can do this best by personally participating in all phases of an order and for all supplier contracts; it is easier to measure and control his or her performance.

Since much follow-up and expediting is a routine work, it often represents an inefficient use of a buyer's time. Some companies therefore develop a hybrid organisation. To achieve the benefits of specialisation, they assign the follow-up and expediting function to a separate expediter. So that the buyer can retain full control of his or her orders, though, each expediter is assigned directly to one buyer (or a buying group).

Thus, the expediter does his or her work as directed by the buyer, and the buyer is helpfully accountable for his or her orders. In practice, the expediter usually handles all routine follow-up enquiries and calls on the buyer for assistance with the difficult or delicate expediting problems. Figure 16.2 shows a typical basic structure of organisation for the follow-up and expediting activity.

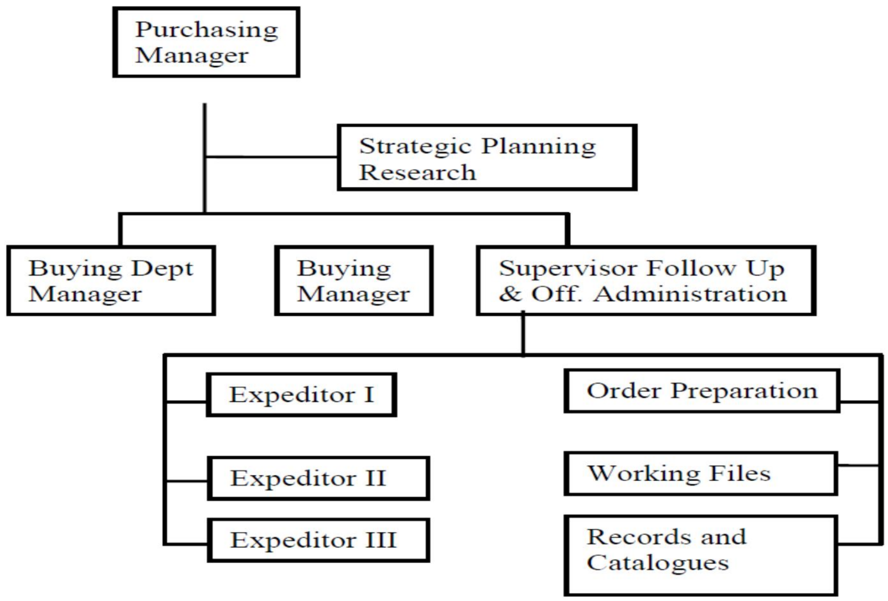

Figure 4.1: A Typical purchasing Organisation Internal structure showing the Expediting section

3.5 Adavantages of the Expedting Function

The progressing or follow-up activity has the following advantages:

1) The supplier is aware of the purchasing department's interest and control

2) Possible late deliveries or delays will be identified via the early warning system and therefore alternative suppliers can be secured or alterations of production programmes can be made, without loss of output.

3) The purchasing manager has a complete and updated visual picture of the purchasing department's position in term of ordering and suppliers.

SELF ASSESSMENT EXERCISE

List the basic characteristics of a good expeditor.

4.0 CONCLUSION

Expediting is an important function, which ought to be centralised. The term "expedite" is used rather loosely in industry. In a more precise sense "follow-up" involves activities to ensure delivery as scheduled. This function is absent in most of the companies. It is true that this function is irrelevant when you have an excellent relationship with the supplier, i.e., with the Electronic Data interchange (EDI) system where company's computer constantly talks to the supplier's computer and the company is able to follow the just-in-time system of inventory. Until this is into practice, expediting will ever be inevitable and must be available centrally.

5.0 SUMMARY

The systematic follow-up of the orders to secure the required delivery is an important purchase function. The purchasing department responsibility for an order does not terminate with the making of a satisfactory contract. Purchasing bears full responsibility for an order until the materials are received and accepted. The purchasing department will often have a wide range of outstanding orders at any given time, orders which are in process of being produced or obtained by the supplier. All these orders will beat various stages of completion. The purchasing executive must maintain a degree of control over this area of the purchasing function. To enable this control to be effective, a system of progressing has to be introduced and monitored.

6.0 TUTOR-MARKED ASSIGNMENT

Explain the issues involved in the follow – up procedure.

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UNIT 13 BUYING INTERNATIONALLY --------------------------------132

Content

1.0 INTRODUCTION

International purchasing is a rather complex discipline. Among the most significant business developments in the last four and half decades have been the rapid growth of international business and the proliferation of multinational firms. Although a number of companies have been engaged in this area for nearly a century, the explosive growth in the size and the number of international firms is a recent phenomenon, as is the much closer central control exercised by managements. Conceptually. "International business is business whose activities involve the crossing of national borders." This definition includes not only international trade and foreign manufacturing, but also encompasses the growing service industry in areas such as transportation, tourism, banking, advertising, construction, retailing, wholesaling, and mass communications. Today, international expansion has made international problems an organic aspect of purchasing and materials management. Indeed, international procurement is one of the most challenging aspects of purchasing and supply management.

2.0 OBJECTIVES

At the end of studying this unit, you should be able to:

1) define concept associated with buying internationally

2) list out and explain each of the approaches to international sourcing
3) state the benefits of buying internationally and the problems associated with it.

3.0 MAIN CONTENT

3.1 International Procurement Concept

Technically, international purchasing involves the performance of the purchasing activities across the national boundaries. International sourcing, or purchasing goods from sellers in other countries for internal use or resale, can be risky, as there is an increasing need to understand foreign environments, purchasing methods and the techniques of adapting purchasing management processes and organizational behaviour to new and different conditions. Dobler and Burt (1996:267) argued that, more recently, the term "foreign sourcing" has largely been replaced with "international sourcing", the process of purchasing from suppliers outside of the firm's country of manufacturing. At a number of leading firms, international sourcing is being replaced with a broader international approach called "global sourcing". Professors Monczka and Trent (1991:3) defined global sourcing; "…as the integration and coordination of requirements across worldwide business wait, looking at common items, processes, technologies, and supplier." This unit essentially focuses on the benefits, risks of and approaches to international sourcing.

3.2 Approaches to International Sourcing

With ever increasing global competition and demands for continuous cost improvement, today's purchasing management is being challenged with the question, "Are we buying from the best place in the world?" Depending on your company's internal resource, skill sets, and long-term strategies, there are many ways to obtain the answer. In this section, attempt will be made to discuss the advantages and disadvantages of the following five most common methods that local companies can use to approach international sourcing:

- Nigeria Sales Contacts of Foreign Suppliers
- Nigeria Global Sourcing Companies
- Overseas Sourcing Representatives
- Direct to Suppliers
- International Procurement Office (IPO)

3.2.1 Nigeria Sales Contacts of Foreign Suppliers

Nigeria Sales Contact of Foreign Suppliers abound in the country and exist in all traditional supplier forms including sales representatives, agents, distributors, Importers, direct sales officers, Trading Companies, Brokers etc. They are distinguished from other global sourcing approaches in that they are undisputedly working on behalf of the supplier.

Buyers approach to them is essentially the same as traditional domestic/local supplier relationships and this of course is their greatest advantage since they generally make buying from overseas extremely simple They generally handle all communications, logistics, import, contractual, and pricing issues on behalf of the foreign supplier to the point that the local purchaser may not even know the name of the foreign `Supplier. Sparing the purchaser from dealing with the many issues that shall be discussed later in the Direct Approach is of course a great advantage; particularly if the purchaser is limited in resources and skill sets, however we should point out the disadvantages.

3.2.2 Nigeria Global Sourcing Companies

Purchasers can take advantages of the capabilities and experience of the Nigeria Global Sourcing Company as in the case of many areas in international business; this segment is not well defined so that purchasers can find these Sourcing Companies having numerous classifications.

Whether they are called Trading Companies, Third Party Sourcing, Importers, Brokers, Global Search or Sourcing Companies they represent the purchaser and not the supplier. The advantages of using the Nigeria Global Sourcing Company approach can be summarised by stating that they can make buying internationally as simple as buying from the Supplier across the street. Usually they provide the following services:

1) Determine items suitable for global sourcing

2) Locate and develop suppliers

3) Negotiate pricing 4) Determine logistics and import costs

5) Coordinate formal evaluation process 6) Place and administer orders

7) Handle communication & Translation

8) Administer Quality Programme

9) Accept financial risk

10) Handle currency issues

1) Pay the supplier

12) Administer logistics and importation processes

13) Pay freight, duty, insurance, broker and other import costs

The major disadvantages of using Nigeria Global Sourcing Companies for global sourcing fall under the categories of (1) increased price, (2) reduced control, and (3) the failure to develop internal capabilities that may be essential to maintaining competitiveness.

Although Sourcing Companies do not usually restrict direct communication between the purchaser and supplier, as a practical matter, most communications flow through the Sourcing Company. As a result, the beneficial exchanges between purchaser and supplier personnel who have specific product knowledge may not occur, and product or process improvements may be missed.

3.2.3 Overseas Sourcing Representatives

Overseas Sourcing Representative (OSR) can be a valuable resource in the Purchaser's efforts to determine the best value in the world. They are based in and usually are citizens of the target country who have extensive knowledge in purchasing, the capabilities of the local supplier base, and acting as buying representative for Foreign Purchasers. They range in size from one-person operations to companies with large staff members with numerous departments specialising in specific commodities. They routinely provide the following services:

1) Understanding the Purchaser's requirements

2) Guidance in selecting viable opportunities

3) Translating 4) Finding and qualifying potential suppliers

5) Helping potential suppliers understand Purchasers

6) Obtaining Quotes

7) Negotiations with Suppliers

8) Arranging for evaluation visits by Purchaser and escorting purchaser while in the country

9) Insure order entry

10) Resolve Issues

11) Facilitate communications

12) Expedite for delivery

13) Resolve any quality issues

14) Handle Shipping

15) Orders can be placed on OSR who will place on supplier

16) OSR may make payment to Supplier

17) OSR may perform or arrange for inspection

18) OSR may take full quality and financial responsibility

Just like Nigeria Global Sourcing Companies, OSRs can greatly speed-up and improve the success rate of international buying projects. Although it is not like buying across the street, since the purchaser must communicate internationally and usually handles all import details, the OSR does give the Purchaser what amounts to an experienced purchasing department in that country. Since most OSRs work on commission paid by the purchaser, the purchaser does not incur a cost unless the OSR come up with a good Supplier used by the purchaser. This is both good and bad news, since the OSR will not continue to support the Purchaser's Global Sourcing efforts unless there are financial successes for the OSR along the way. Finding the best supplier in a country is:

1) Usually made easier by using an OSR since they know the reputations of the Suppliers and are more likely to find the small obscure suppliers who often offer the greatest values.

2) OSRs can be invaluable in negotiations since they know the customs, culture, and the objectives of the Supplier in ways not known or easily understood by the Purchaser.

3) OSRs also have the ability to make in country visits by the purchaser much more productive since they handle the logistics.

4) The ability of many OSRs to provide technical expertise and perform or arrange for quality inspection.

The major disadvantages in using an OSR are that:

1) They will add 5 to 20% to the direct material cost.

2) Although there are many potential OSRs in each country, their capabilities and performance vary widely so that purchasers have to exercise a great deal of due diligence in the selection process.

3) Additionally OSRs are usually good in just one country or in some cases good in only one major city, so that if an area such as Asia is targeted, the Purchaser will have to select OSRs for each targeted country

4) Since OSRs may also be limited in product expertise, specialising in stamping, castings, or electronic For example, purchasers having varied product categories to source may do well to have multiple OSRs.

3.2.4 Direct

With today's improved communications and the availability of high quality Suppliers all over the world, many purchasers deal directly with the Supplier in the foreign location without the use of any third party. According to a survey reported in the purchasing journal (April, 1997), of those who source overseas, use the direct approach.

When considering whether or not to use the Direct Approach, Purchasers must first understand that all the services identified above as being by Nigeria Global Sourcing Companies and OSRs, will have to be provided by the Purchasers in the Direct Approach. This means that the following skill sets among others will have to exist or be developed by the Purchaser for maximum success in international Sourcing:

1) Targeting countries
2) Locating suppliers in targeted countries
3) Selecting suitable products
4) International and country specific business practices
5) Understanding the foreign supplier's capabilities, expectations, and needs.
6) International terms and conditions
7) Dispute resolution
8) International negotiations
9) Communications
10) Understanding cultural differences
11) Inspection at foreign locations
12) Payment methods
13) International transportation, insurance, etc.
14) Import process, regulations and duties
15) Country specific export regulations
16) Currency exchange
17) International order administration and overseas expediting
18) Packaging for international shipments In addition to the above skill sets, the purchaser must also have available the financial and human resources to carry out the Global Sourcing Process.

These resources often involve the need for additional people and considerable monies for travel, research, training, qualification and approval. For most purchasers, the decision to go Direct should be based on;

1) The expected volume of international purchases,

2) The commitment to long-term international sourcing strategies and

3) The internal resources available.

The direct approach cans results into the advantages of;

1) greater control

2) development of internal capabilities,

3) avoiding the country references of third parties, and

4) obtaining lower total material cost.

3.2.5 International Procurement Office (IPO)

Having an International Procurement Office (IPO) is “actually” having the Purchaser’s own Procurement Operation located overseas. An IPO is owned and operated by the purchaser, staffed with the purchaser’s employees and does sourcing only for the Purchaser. IPO while providing all of the services defined above for the OSR, also gives the following advantages to the Purchaser over the OSR.

1) No third party mark-ups
2) Dedicated overseas resource with no other
3) Direct in –country purchaser interface with the supplier
4) Development of long-term in –country relationships with government and business community.
5) Better communications by direct interface with purchaser’s engineering, production, and quality groups.
6) Reduces purchaser’s need for foreign travel.
7) Better in-country quality and engineering support.
8) Greater flexibility to coordinate with other purchaser’s overseas entities such as sales offices, manufacturing plants. joint ventures, etc. to obtain advantages in administrative cost, taxes, currency, human resources, import / export status, logistics, etc.

With all the valuable services provided by IPOs and the above advantages, why do not all international Purchasers use them? The major reasons are that they are:

1) Costly and challenging to operate;

2) Usually difficult to staff, and

3) Add to the Purchaser’s head count.

Even with an IPO, the purchaser must still develop import capabilities. These issues notwithstanding and because of their many advantages, IPOs should be considered when:

1) there is sufficient annual volume to cover expenses,

2) a long-term –commitment to the country or region, and

3) the direct approach is not providing the expected results.

3.3 The Benefits and Risks of International Sourcing

3.2.4 Why Purchasing International Goods and Services

International sourcing requires additional efforts when compared with domestic sourcing, but it can yield large rewards.

1) Quality

A key reason for international sourcing is to obtain the required level of quality.

2) Timeliness

A second major reason for purchasing international goods and services is, generally, the dependability of the supplier in meeting scheduled requirements

3) Cost

International sourcing generates expenses beyond those normally encountered when sourcing domestically. Nonetheless after all of the additional costs of "buying international" are considered, in the case of many materials it frequently is possible to reduce the firm's total cost of the materials through international sourcing.

4) Product and Process Technologies

No country holds a monopoly on new technology. International sources in some industries are more advanced technologically than their domestic counterparts. Not to take advantage of such product or process technologies can result in a manufacturer's losing its competitive position *vis-a-vis* manufacturers that incorporate the new technologies.

5) Broadening the Supply Base

Professional buyers want to develop and maintain an adequate supply base for required materials. It may be necessary to develop international suppliers in order to have a competitive supply base. In some cases, there may not be a qualified domestic source.

6) Counter Trade

Many countries require their non-domestic suppliers to purchase materials in their country as part of the sales transaction. These arrangements commonly are called barter, offsets, or counter trade.

3.3.2 Problems Associated with International Procurement

1) Culture and Communications

The nature, customs, and ethics of individuals and business organisations from two different cultures can raise a surprising number of obstacles to successful business relations. What is considered ethical in one culture may not be ethical in another. Differences in culture, language, dialects, or terminology may result in miscommunication and cause problem.

2) Payment Terms Conditions

rom the buyer's point of view, the preferred method of payment is after receipt and inspection of the goods. However, it is customary in many countries for advance payments to be made prior to commencing work. Such a provision ties up the purchaser's capital.

3) Long Lead Times

Variable shipping schedules, unpredictable time requirements for customs activities, the need for greater coordination in international purchasing, strikes by labour unions, and storms at sea (which can cause both delays and change) usually result in longer lead times.

4) Additional Inventories

The quantity of additional inventory needed when purchasing from foreign sources can be difficult to determine quite often, however, the additional inventories are not as large as one might expect. Nevertheless, inventory –carrying costs must be added to the purchase, the freight, and the administrative costs to determine the true total cost of buying from international sources.

5) Quality

As previously mentioned, international suppliers frequently are utilized because many of them can provide a consistently high level of quality. But problems do exist. Non-domestic suppliers tend to be less responsive to necessary design changes than do their domestic counterparts.

6) Higher Costs of Doing Business

The need for translators, communications problems, the distance involved in making site visits, and so on all add to the cost of doing business with international suppliers. Port-order services are more complicated because of currency fluctuations, methods of payment, customs issues, and the utilisation of import brokers and international carriers. Inadequate local (international) logistical support functions such as communication systems (telephones, telexes, and fax machines), transportation systems, financial institutions, and so forth can complicate communications and product distribution.

SELF ASSESSMENT EXERCISE

What are the services of the global sourcing companies in the international procurement functions?

4.0 CONCLUSION

International sourcing, or purchasing goods from sellers in other countries for internal use, resale, can be risky, as there is an increasing need to understand foreign environments, purchasing methods and the techniques of adapting purchasing management process and organisational behaviour to new and different conditions. Today, international expansion has made international problems an organic aspect of purchasing and materials management. Indeed, international procurement is one of the most challenging aspects of purchasing and supply management.

5.0 SUMMARY

With ever increasing global competition and demands for continuous cost improvement, today's purchasing management is being challenged with the question, "are we buying from the best place in the world?' Depending on your company's internal resources, skill sets and long-term strategies, there are many ways to obtain the answer. Today, international expansion has made international problems an organic aspect of purchasing and materials management. Indeed, international procurement is one of the most challenging aspects of purchasing and supply management.

6.0 TUTOR -MARKED ASSIGNMENT

Would you advise your manufacturing company to have an international procurement office?

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UNIT 14 MANAGING PURCHASING ACTIVITIES --------------142

Content

1.0 INTRODUCTION

Like other key management tasks, procurement has aspects that are concerned with operational activities (day-to -day), with tactical matters (medium term-perhaps up to one year), and with strategic issues (long term). Management is a process or activity, which takes place at all levels in an organisation. It is not carried out only by people with 'manager' in their job title. Departmental heads, supervisors, foremen, bishops, presidents or even Boy's scout leader all performs managerial function; although obviously not all of the same type or of equal importance. It is the task, which a person performs which is of importance, not the job title. Hence, managers whoever they may be, tend to have the same set of functions in an organisation. The task of managers is to get results through their subordinates. This he does by planning, organising, directing and controlling. These activities are called management functions, because they identify broadly what managers do. These managerial functions are generally considered central to a discount of management by authors.

2.0 OBJECTIVES

At the end of studying this unit, you should be able to:

• define planning and apply planning steps to your procurement activities

• discuss and state the implications of budgeting and purchasing research activities to the purchasing function.

3.0 MAIN CONTENT

3.1 The Planning Process and Techniques for Materials Management

The purchasing department must have a plan for carrying out its activities. In fact, managerial efficiency starts with planning. Without a plan, purchasing will be carried out in a stab-and grab opportunistic manner, and the department may be very much overloaded during some months and be relatively without much work for the rest of the year. The first function of management is therefore, the development of a series of plans that establishes the framework within which future activities will be conducted. Every managerial job demands that planning be done before the other functions of management are executed. Planning, simply put, is a decision-making process that pertains to the future. It involves all activities leading to the formulating of objectives and deciding upon the means of meeting them. A useful working definition of planning is given by the Chartered institute of Management Accountant (CIMA) as:

> *The establishment of objectives and the formulation, evaluation and selection of the policies, strategies, tactics and actions required to achieve these objectives.*

Every planning process practically speaking attempt to answer such questions as;

- What action should be taken?
- Why should the action be taken?
- Who shall take the action? and
- How shall the action be taken?

Planning is not an end itself, its primary purpose is to provide the guidelines necessary for decision and resulting action, throughout the organisation. Planning is done on both the formal and informal basis and the planning process uses information from both the internal and external sources. The plan is the net result of the planning process. A plan is a predetermined course of action about what has to be done to achieve an objective. At the beginning of the year, the purchasing department must determine what to buy and when. It must have time-schedules and a programme for purchase. In purchasing, time is so essential. A plan can be simple or complex. It can cover the short-term or the long term.

1) Long-Term or Strategic Plans

These are plans designed by top managers to meet or achieve the company –wide or corporate objectives. It involves a longer time period say two –to- five (and in some cases longer) years and relies on more unreliable long – term forecasts.

2) Short Range or Operational Plans

This shows how strategic plans will be implemented in day-to-day activities. Operational plans thus cover some functional areas such as production, marketing, finance etc. and periods of up to a year and such other situations that are likely to come up monthly, weekly and sometimes daily.

3.1.1 The Planning Steps Regardless of its complexity, most planning can be done in a relatively simple series of steps. Hence, managers would follow essentially, the same process or step in any thorough planning. Certain of the steps are however easily accomplished, but in practical terms, the series of steps are of general application. Koontz et al (2000) presented the steps which constitute the rational decision – making process to include:

1) Discovering an opportunity to exploit or problem to solve

(2) Establishing (planning) objectives

(3) Determining and, or considering planning premises

(4) Determining alternative courses of action

(5) Evaluating the alternative courses of action

(6) Selecting a course

(7) Implementation

(8) Planning review (control).

3.2 Planning Techniques for Materials Management

In preparation for each new fiscal year, most firms construct a company-wide annual operation plan. A forecast of the scope and magnitude of key functional activities is the starting point for development of the plan. In a manufacturing firm, this is the sales forecast. The sales forecast is then translated into an aggregate production plan and master schedule, taking into consideration finished goods inventory levels as well as desired in – i.e. process inventory levels for specific items. All materials planning subsequently flows from the preliminary master production schedule. Materials managers apply the basic concepts of planning techniques, formally and informally, in making a multitude of daily business decisions. Dobler D.W. (1981) identified and extensively discussed three widely used techniques in materials planning, namely; budgeting, purchasing research and network analysis, and planning.

3.2.1 Budgeting

Budgets are one of the traditional planning and control tools of business and are used in organisations of all types. A budget may be defined as a financial plan showing anticipated income and expenditure for a period of time, for the purpose of attaining a given objective. CIMA specifically defined a budget as: A plan quantified in monetary terms, prepared and approved prior to a defined period of time, usually showing planned income to be generated and/or expenditure to be incurred during that period and the capital to be employed to attain a given objective. Budgets are usually prepared for both individual departments and the business as a whole. The basic concept of the budget is to balance expenditure with income. The budget should help ensure that expenditure is not exceeding income on an ongoing basis; it is once – a year exercise. A well-prepared budget helps management in several ways. Perhaps its primary functions are to;

(1) Serve as a guide in planning financial operations within the company.

(2) A second purpose is to establish limits for departmental expenditures.

(3) A third purpose of budget is to act as a coordinating device among the various functions of the business.

(4) A fourth purpose of budgets is that of control.

All department heads typically prepare a budget for their area of responsibility and submit it to the controller. A company budget, thus, typically composes of numerous sub-budgets, each covering specific departmental operational activities. This is graphically illustrated in figure 14.1 below:

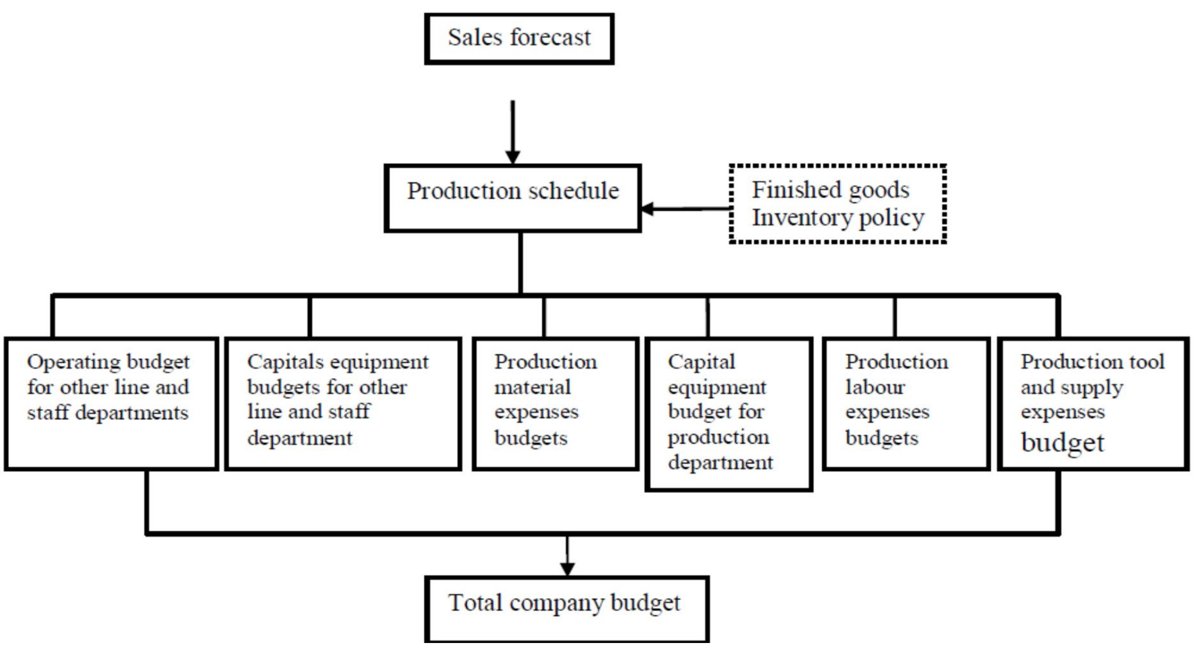

Figure 14.1: Major constituents of a total company budget.

Materials are however, primarily concerned with two budgets the materials budget and their respective departmental operating budgets.

1) Purchase (Materials) Budget

The purchase budget is based entirely upon the sales and production budgets. In theory, the purchasing function extrapolates (i.e. work out) materials requirements from the production budget projects prices and thereby phasing deliveries in accordance with production schedules. The implication is that detailed preparation of annual materials budgets is therefore realistic only for those products whose sales can be forecasted with reasonable accuracy or for materials that are used in a variety of products whose aggregate demand can be forecasted. When purchasing budget is to be expressed in terms of naira, the purchasing manager is normally called upon to supply the budget department with two types of information:

i. Estimates of materials prices during the coming year, and
ii. Plans for the specific timing of purchases.

Timing of purchases is vital in respect of cash management, which needs to control the amount to cash required during each period. The task of estimating price trends however requires the consideration of many things including;

a) Political or economic factors, or domestic, which may affect price;
b) Comparative currency changes and levels of inflation in pertinent countries;
c) Possible changes in import duties, transit and insurance charges, etc. as they affect from overseas;
d) The position of long term contracts as regards fixed prices;
e) The supply position of materials and components in relation to overall demand;
f) Lead times and the potential effects of having to purchase from more expensive alternative sources in the event of failure.

2) **The Departmental Operating Budget**

This budget is essential for the effective planning and control of departmental operations. Along with other departmental heads, the procurement manager makes periods. This is estimate of the costs, which will be incurred during the budgetary period. This estimate is usually produced annually and will include;

(1) Total departmental salary bill

(2) Total expenses for the period

(3) Total cost of departmental supplier; and

(4) Capital expenditure.

Without doubt, costs vary widely among firms. However, small business organisation pay more over every naira value purchase made to operate their purchasing departments than do large firms, and operating costs tend to be higher among durable goods producers than among non-durable goods producers.

3.2.2 Purchasing Research

In the planning stages, most purchasing actions require certain research investigations. Because he is confronted with numerous unknown facts, an industrial materials buyer cannot make an enlightened purchasing decision until these unknown areas are explored. The formal purchasing research concept recognises the need for generating and analysing a sizable amount of detailed data when planning procurement operations. If the required data is available or can be developed effectively in other existing departments, the job of the purchasing research group is to obtain such information and organise it for use in purchasing.

If the information is nowhere available with the firm, it is the purchasing research staff's job to generate it. Hence as a concept, purchasing research has been defined as: The responsibility concerned with the process of obtaining, organising, and interpreting data, which facilitate procurement planning and hence improve the total materials management operation. A formal purchasing research programme serves as a procurement planning tool. The general objective of such a programme is to undertake in-depth investigations, which improve total procurement performance and increase the function's contribution to company profits. Operationally, the purchasing research work can be accomplished in several ways.

(1) Some company's purchasing and supply departments include these activities as parts of a senor buyer's job.

(2) In a majority of the more progressive firms, however, this purchasing research work is assigned to a group of staff specialists who specifically trained in these activities. Lanner Lee Jr. (1981, p. 388) listed a number of developed classifications of purchasing research staff functions, which has since been adopted by numerous firms. This includes; (1) Procurement planning (2) Research on purchased materials

(3) Research on the purchasing system

(4) Special projects.

(1) Purchasing Planning

This involves the study of the company's short and long- range materials requirement and a determination of acceptable cost objectives.

(2) Research on Purchased Materials

This involves both economic and technical investigation. In the economic area, forecasts of general economic conditions are made, and studies of the industries and commonly markets are undertaken.

Technical investigations primarily focus on two major programmes, which are frequently conducted on a company-wide basis –make- or buy and value analysis.

(3) Research on the Purchasing System

This research classification involves studies of administrative problems. Specific activities include the analysis of such things as policies, procedures, reports, organisation structures, job specification, wage payment plans, and so on.

(4) Special Projects

This is often a fourth area of informal purchasing research activity. Staff assistance is frequently needed to study a multitude of special problems that arises in areas such as inventory management, traffic management, quality control, and vendor relations, for example.

3.3 Purchasing and Record Keeping

The procurement department is obliged to maintain a complete set of records regarding the operations and activities of the department. Good record keeping is germane to the achievement of the purchasing and inventory management objectives, of making available the right product, in the right quantities, at the right time, in the right place. The file of a purchasing department thus contains an endless flow of operational data. The information stored will include details of the following:

(1) Suppliers' past performance and evaluation of them. Technically this is a record of closed orders. (2) Current price of goods and services required by the organisation.

(3) Copies of orders, contracts and current agreements. All buyers need immediate access to information concerning the status of their outstanding orders.

(4) Specification and standards as set by the user department.

(5) Supplier Record: To provides quick access to information in a single record file. A separate card or computer is maintained for each major supplier. In this record is recorded the address telephone number, and the name of personnel to contact on specific matters of inquiry.

(6) Contract Record: Today, most firms are purchasing an increasing number of items on a long-term contractual basis. In such cases, it is usually convenient to consolidate all contracts in a separate file. (7) Progressing data for outstanding

3.4 Handling Orders

In procurement, various types of orders exist. This depends largely on a number of factors such as:

(1) The nature of the business;

(2) The characteristic of the various materials needed,

(3) The market structure,

(4) The quantity required of each item as well as the frequency of need. For this reason, the various types of orders are classified as follows, depending on the circumstances surrounding each requirement.

(1) Small Orders

Small orders are a perennial problem in every organisation and a serious problem in some. Recent research evidence has shown that most companies' expenditure is on small orders that are hardly more than ten percent of their annual materials expenditure. The very nature of business requires the purchase of many low-value items. Small orders are however not only costly to the buyer but also to the seller. Various methods are nevertheless in use by managers to minimize the small-order problem.

(2) Rush Orders

Purchasing basic responsibility is to its internal customer, i.e. the various departments in an organisation. In serving its customers, the concern is to develop an orderly and systematic pattern of operation that efficiently utilizes the resources to that organisation. This situation calls for approaches to deal with the problem of handling emergency needs that inevitably arise in any business operation. A clear, special procedure for processing rush requisition in all organisations. Rush orders always cost more than if they were handled through the normal purchasing system. High prices are frequently paid because rush purchases are not as thoroughly investigated as those handled in the normal routine. To discourage the incidents of rush orders that arise because of poor planning, David N. Burt (1996p. 79) presented three approaches that have proved successful overtime.

(i) The first involves a concerted effort to coordinate the activities of the user departments and purchasing.

(ii) A second approach is to reduce unjustifiable requests which require the requisitioner to obtain approval from a general management executive for all emergency requisitions.

(iii) The final approach assesses the requisitioning department for a predetermined service charge for each emergency requisition processed.

(3) Centralised Stores System

A store system is the first approach typically used to reduce the frequency and volume of small-order-purchasing activity. When experience shows that the same supply items are ordered in small quantities time after time, the logical solution is to order these items in larger quantities and place them in a centralised store or inventory for withdrawal as needed.

(4) Blanket orders

A blanket order system is designed to solve the problem a company's inability to carry thousands of items as inventory just like a central stores system is designed to solve the small order problem only for items that are used repetitively.

• On the basis of careful analysis of past purchases, the buyer determines which materials should be handled through blanket orders.

• After bidding or negotiation, the buyer selects a supplier for each items, or family of items, and issues a blanket order to each supplier.

• The blanket order typically states that all requirements are to be delivered upon a receipt of an order from the buyer or other authorized person.

• On receiving a requisition for one of the materials, the buyer merely sends a brief order form to the supplier. On the release or order form are noted the blanket order number, the item number, and the quantity to be delivered.

The blanket order system offers a number of advantages:

1) Clear reduction in the issuance of purchase orders and clerical work in purchasing, accounting and receiving.

2) It releases buyers from routine work, giving them more time to concentrate on major problems

3) It permits volume pricing by consolidating and grouping requirements.

4) It develops longer-term and improved buyer-supplier relationships. Blanket order system nevertheless requires adequate internal control to function effectively. Absence of this control element can encourage petty fraud and poor supplier performance. The elements essential to effective control are:

i. A numbered purchase order

ii. A record of authorised delivery releases.

iii. Bona fide evidence of receipt of the materials.

In spite of the several benefit of this method of handling orders, the blanket order has not enjoyed popular applications in business organisations.

5) System Contracting

As the name implies, system contracting involves the development of a company-wide agreement, often a one to five year requirements contract, with a supplier to purchase a large group (or family) materials. It can be viewed as an extension and more sophisticated development of the blanket order – purchasing concept.

Estimate usage is usually included, along with a fixed price for each item and an agreement by the supplier to carry an adequate stock of each item to meet the buyer’s needs. Various types of supplies and commonly operating equipment, typically purchased from distributors, are the materials most often covered by these types of agreements.

6) The Telephone Order System

Most companies now use a telephone or fax ordering system to reduce the paperwork associated with small – order purchasing. Under this system, when the purchasing department receives a requisition, it does not prepare a formal purchase order. Instead, the order is placed by telephone or fax, and the requisition is used in the receiving procedure. This system goes one step further in the elimination of paperwork; the firm’s suppliers send no invoice for telephone purchases.

7) Electronics Order System

A number of electronic communication systems currently are available to transmit materials purchase requests without writing orders or talking on the telephone. One particular approach that evolved is the internet and electronic commerce. Meaningful studies and research findings have shown that the internet and e-commerce have become a vivid representative of core business parameters today around the world. There is now a tremendous amount of activities as companies begin to set – up their customer service functions on the internet. The system is particularly applied to the purchase of repetitively used items whose recurring orders can be placed using the same input source. Clearly, the use of an electronic ordering system requires a blanket order or similar contractual arrangement with the supplier.

8) Petty Cash System

Most firms today use a petty cash fund for making small, onetime purchase. For this purpose, many firms defined small as under N 20,000. it is often less expensive for an individual user to buy minor items personally and pay for them a petty cash fund than it is to buy them through the conventional purchasing system, any inefficiency that may arise because of lack of buying skills is more than compensated for by the administrative saving resulting from not placing a purchase order.

3.5 Ethics in Purchasing

In many respects, ethics is far more important in today's procurement environment than it has ever been in the past. Whereas before there was adversarial relationship between buyers and suppliers, today there is partnership. Procurement chain or circle management is the reason behind this change, and it is a process which requires a high level of trust in order for the partnership to work to the mutual benefit of both the buyers and sellers.

Ethics has more significance to purchasing personnel who deals with many suppliers, evaluate them and award them contracts. Attempts will naturally be made to seek favour with him and, as such, he is subjected to temptation day in and day out, it becomes imperative, therefore, that all public and private sectors' purchasing personnel be entirely cognizance of the necessity for ethical behaviour. It takes only slightest limit of impropriety to cause doubt on behaviour, whether through perception or an actual event. As a concept, ethics simply means what is right. Ethics involves learning what is right or wrong and simply doing it.

Many philosophers consider ethics to "be the science of conduct". Ethics has therefore been broadly defined as: "Standards of conduct that distinguish between right or wrong, good and bad, virtue and vice, justice and injustices." Purchasing from the layman's definition simply means the act of buying or to acquire. Ethics in purchasing means what is right in the act of purchasing. It implies the various dos and don'ts of the purchasing profession, which has to do with one's behaviour, and conducts in purchasing practice. More specifically, purchasing ethic has been defined as: 'Concerning the rightness or wrongness of actions taken by purchasing professional while pursuing the business goals of his or her organisation'. Purchasing ethics primarily concentrates on what is the correct behaviour of a purchasing professional as he performs his duties dealing with the acquisition of goods and services in order for his company to produce a product or provide a service.

3.6.1 Division of Ethics

Ethics in procurement is divided into values, norms and rules conduct. These are further enumerated below:

a) Value Value is this context is used to mean moral or professional standard to behaviours in purchasing, and this includes:

(1) Honesty/Integrity
(2) Responsible management
(3) Serving the public interest
(4) Professionalism

b) Norms of Ethical Behaviour

In procurement, the following standard or pattern of social behaviour is expected among the professionals:

1) To consider first, the interest of one's organisation in all transaction.

2) To strive for increased knowledge of materials and processes of manufacturing.

3) To participate in professional development programmes.

4) To subscribe to and work for honesty in buying and selling.

5) To accord a prompt and courteous reception to all who call on a legitimate business mission.

(6) To abide by and to encourage others to practice the professional code of ethics of the Nigerian Institution of Purchasing & Supply Management (IPSM) and its affiliated institutes and corporations. 7) To counsel and assist fellow purchasers in the performance of their duties.

8) To cooperate with all organisations and individuals engaged in activities, which enhance the development and standing of purchasing and materials management.

9) To be receptive to competent counsel from one's colleagues and guided by such counsel without impairing the responsibility of one's office.

10) To buy without prejudice, seeking to obtain the maximum value for each naira of expenditure.

c) Rules of Conduct

In applying these rules of conduct, personnel involved in purchasing should follow the guidance set out below:

(1) Declaration of Interest

(2) Confidentiality and Accuracy of Information

(3) Competition

(4) Business Gifts and Hospitality

To preserve the image and integrity of those involved in purchasing and the profession. Business gifts other than items of small intrinsic value should not be accepted.

(5) Environmental Issues.

Anyone involved in purchasing should recognise their responsibility to environmental issues consistent with their corporate goals or missions.

SELF ASSESSMENT EXERCISE

Highlight the series of simple steps involved in most planning.

4.0 CONCLUSION

It is important to emphasis that in many organisations, purchasing is a primary function and therefore a key influence on the business. In other words, there is a necessary requirement to buy materials and equipment in order to produce, and without those purchases the business could not function. When this situation is linked to the fact that the average manufacturing company spends well over half its income on buying goods and services, it is clear that the management of purchasing should command the attention of the company's top management level. A materials manager's responsibilities however differ little from those of other functional manager's. All managers function primarily as decision makers. Although the details involved in managing a purchasing department differ from those involved in managing an engineering or production department, the basic managerial activities are the same. All managers develop the specific pattern of activity required in their own functional areas by applying the same general management concepts.

5.0 SUMMARY

The procurement department must have a plan for carrying out its activities. In fact, managerial efficiency starts with planning. Without a plan, purchasing will tend to be carried out in a stab-and-grab opportunistic manner, and the department may be very much overloaded during some months and be relatively without much work for the rest of the year. The first function of management is therefore, the development of a series of plans that establishes the framework within which future activities will be conducted. Every managerial job demands that planning be done before other functions of management are executed. Dobler D.W (1981) identified and extensively discussed three widely used techniques in materials planning, namely; budgeting, purchasing research and network analysis and planning. The purchasing department is obliged to maintain a complete set of records regarding the operations and activities of the department. Good record keeping is germane to the achievement of the purchasing and inventory management objectives, of making available the right product in the right qualities, at the right time, in the right place.

The significance of computerisation for procurement and materials management is readily understood when one considers the amount of purely administrative work involved in the procurement cycle of the average buying company. Literally, thousands of requisitions, requests for quotation, purchase orders, change orders, status reports, receiving records, invoices, and other documents must be processed and recorded. Today, a computer based system for handling these activities is a necessity.

6.0 TUTOR-MARKED ASSIGNMENT

State clearly the basic materials based activities that can be well performed by a computer based system.

7.0 REFERENCES/FURTHER READING

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UNIT 15 DELIVERY PERIOD, TERMS OF DELIVERY, TRANSPORTATION, TRANSIT INSURANCE, DELAY IN SUPPLY, CANCELLATION OF CONTRACT--------------------156

Content

1.0 INTRODUCTION

In this unit, the issues concerning Delivery Schedule including Transportation & Transit Insurance and various aspects covering Delays in Supply will be discussed.

2.0 OBJECTIVE

At the end of studying this unit, you should be able to;

Discuss with demonstrable examples, terms and conditions that are associated with delivery, insurance, delay and cancellation of purchased goods

3.0 DELIVERY PERIOD, TERMS OF DELIVERY, TRANSPORTATION, TRANSIT INSURANCE, DELAY IN SUPPLY, CANCELLATION OF CONTRACT

3.1 Delivery Period

The period for delivery of the ordered goods and completion of any allied service(s) thereof (like installation and commissioning of the equipment, operators' training, etc.) are to be properly specified in the contract with definite dates and the same shall be deemed to be the essence of the contract. Expressions such as 'immediate', 'ex-stock', "as early as possible', 'off the shelf', etc. must not be used to indicate contractual delivery period.

3.2 Terms of Delivery

The terms of delivery is decided depending on the nature of goods to be purchased, transportation facility available, location of the user, location of the prospective suppliers etc. Terms of delivery *inter alia* determine the delivery point of the ordered goods from where the purchaser is to receive / collect the goods. Terms of delivery have direct bearing on the quoted prices.

3.3 Linkage between Terms of Delivery & Date of Delivery

Delivery dates in respect of contracts incorporating standard and commonly used terms of delivery shall be deemed to be as follows:

Terms of Delivery	Date of Delivery
Ex-Works	The date the supplier delivers the goods to the purchaser at its (supplier's) factory/premises.
FOR, Station of Despatch **(**FOR stands for Free on Rail)	The date on which the goods are placed by the supplier on rail with clear RR (Rail Receipt).
FOR, Destination	The date on which the ordered goods reach the destination railway station specified in the contract.
CIP, Destination (CIP stands for Carriage and Insurance paid)	The date on which the delivery is effected at the destination mentioned in the contract.
Local Delivery at Site	The date on which the delivery is made at the consignee's site mentioned in the contract.
FAS, port of shipment (FAS stands for Free Alongside Ship)	The date on which the supplier deliver the goods alongside the vessel at the specified port of shipment. This date is reflected in the Bill of Lading.
FOB, port of shipment (FOB stands for Free on Board)	The date on which the supplier delivers the goods on vessel's board at the specified port of shipment. This date is reflected in the Bill of Lading.
CIF, port of destination (CIF stands for Cost, Insurance and Freight)	The date on which the goods arrived at the destination port.

It must be pointed out that the FAS, FOB & CIF terms of delivery are applicable for goods which are directly imported from foreign countries against the subject contract and not imported already by the supplier under its own arrangement. The CIP terms of delivery may be applied both for domestic as well as imported supplies.

3.4 Instructions for Transportation of Imported Goods

As per the general policy of Government of Nigeria, all import contracts are to be concluded on FOB / FAS basis. In case a Ministry / Department desires any departure from the above policy including placement of contracts for import of foreign goods, prior permission is required to be obtained from Ministry of Surface Transport.

In case of FOB/FAS contracts, shipping arrangements shall be made by the Shipping Co-ordination and Chartering Division/Shipping Co-ordination and Officer, Ministry of Transport. Notice about the readiness of Cargo for shipment shall be given by the supplier from time to time at least 6 (six) weeks in advance for finalising the shipping arrangement, through Fax/Telex and courier, to the Chief Controller of Chartering, Shipping Co-ordination Officer, Ministry of Transport.

Within 3 (three) weeks of receipt of the advance notice, as above, the said Chief Controller of Chartering, Shipping Coordination Officer will advise the supplier, through Fax/Telex and courier when and on board what vessels, these goods or such part thereof are to be If the advice for shipping arrangement is not furnished to the supplier within 3 (three) weeks as aforesaid or if the vessel arranged is scheduled to arrive at the specified port of loading later than 15 (fifteen) days of the date of readiness of cargo, as aforesaid, the supplier may arrange for such transport on alternative carriers with the prior written consent of the purchaser.

Where the supplier is required under the contract to deliver the goods on FOB/FAS basis and to arrange on behalf and at the expense of the purchaser for ocean transportation on Indian flag vessels or vessels of conference lines in which India is a member country, the supplier may arrange for such transportation on alternate carriers if the specified Indian flag vessels or conference vessels are not available to transport the goods within the time period(s) specified in the contract, with the prior written consent of the purchaser.

Should the goods or any part thereof be not delivered on the nominated vessel (except in case where prior written consent of the purchaser was obtained), the supplier will be liable for all payments and expenses that the purchaser may incur or be put to, by reason of such non-delivery including dead and extra freight, demurrage of vessels and any other charges, whatsoever incurred by the purchaser.

The supplier shall not arrange part-shipments and/or transhipment without the express/prior written consent of the purchaser. Where the supplier is required under the contract to deliver the goods under CIF/CIP terms, no further restriction shall be placed on the choice of the ocean carrier except that the shipment shall be made by vessels belonging to the conference lines in which Nigeria is a member country.

It is also important to point out that before processing any case for placement of contract on FAS/FOB/ CIF/CIP basis for imported goods, the purchase organization should check the contemporary government instructions in this regard for further necessary action.

3.5 INCOTERMS

Unless otherwise specifically agreed to by the purchaser and the supplier and incorporated in the contract, the applicable rules & regulations for transportation of goods from foreign countries will be as per the contemporary version of International Commercial Terms (Incoterms) evolved by International Chamber of Commerce, Paris. Incoterms are the official rules for worldwide interpretation about the duties, obligations, etc. of the buyer and the seller for transportation of the goods from seller's country to buyer's country. Incoterms are recognised by the United Nations Commission on International Trade Law (UNCITRAL) as the global standard for such interpretation. The purchasing Ministry/Department, while ordering goods for importation from foreign countries are to take note of the same.

3.6 Air Consignment

As per the extant directive of the Government, airlifting of the imported goods from abroad will be done only through the National Carrier or any other like the Air Afrik wherever applicable. However, before processing any contract involving import of goods through air, contemporary instructions in this regard may be ascertained and followed.

3.7 Insurance

Wherever necessary, the goods supplied under the contract, shall be fully insured in a freely convertible currency against loss or damage incidental to manufacture or acquisition, transportation, storage and delivery in the manner specified in the contract. If considered necessary, the insurance may be done for coverage on "all risks" basis including war risks and strike clauses. The amount to be covered under insurance should be sufficient to take care of the over all expenditure to be incurred by the purchaser for receiving the goods at the destination.

It is also important to point out that insurance of imported goods/equipment would need to be arranged on a very selective basis and only for cases where the value of individual shipment is expected to be in excess of million of naira.

Where delivery of imported goods is required by the purchaser on CIF/CIP basis, the supplier shall arrange and pay for marine/air insurance, making the purchaser as the beneficiary. Where delivery is on FOB/FAS basis, marine/air insurance shall be the responsibility of the purchaser.

3.8 Distribution of Despatch Documents for Clearance/Receipt of Goods

The supplier shall send all the relevant despatch documents well in time to the purchaser to enable the purchaser clear or receive (as the case may be) the goods in terms of the contract. Necessary instructions for this purpose are to be incorporated in the contract. The usual documents involved and the drill to be followed in general for this purpose are as follows:

(i) For Domestic Goods

Within 24 hours of despatch, the supplier shall notify the purchaser, consignee, …….. (others concerned), the complete details of despatch and also supply following documents by registered post / speed post (or as instructed in the contract):

(a) Supplier's Invoice indicating, *inter alia* description and specification of the goods, quantity, unit price, total value;

(b) Packing list;

(c) Certificate of country of origin;

(d) Insurance certificate;

(e) Railway receipt/Consignment note;

(f) Manufacturer's guarantee certificate and in-house inspection certificate;

(g) Inspection certificate issued by purchaser's inspector and

(h) Any other document(s) as and if required in terms of the contract.

(ii) For Imported Goods

Within 24 hours of despatch, the supplier shall notify the purchaser, consignee, …….. (others concerned), the complete details of despatch and also supply following documents by air mail / courier (or as instructed in the contract):

a) Supplier's Invoice giving full details of the goods including quantity, value, etc.;

b) Packing list;

c) Certificate of country of origin;

d) Manufacturer's guarantee and Inspection certificate;

e) Inspection certificate issued by the Purchaser's Inspector;

f) Insurance Certificate;

g) Name of the Vessel/Carrier;

h) Bill of Lading/Airway Bill;

i) Port of Loading;

j) Date of Shipment;

k) Port of Discharge & expected date of arrival of goods and

l) Any other document(s) as and if required in terms of the contract.

3.9 Installment Delivery

The goods ordered in a contract to be delivered by installments may be an "entire" contract or a "severable" contract as per illustrations given below:

i) Entire Contract: Total number of units of the required goods is100.

Delivery Schedule: Delivery to commence after 30 days of placement of contract and to be completed within 4 months @ 25 units per month i.e., completion by 30.06.2006 or earlier.

ii) Severable Contract: Total number of units of the required goods is 100.

Delivery Schedule: 25 units by 31.03.2006; 25 units by 30.04.2006; 25 units by 31.05.2006; 25 units by 30.06.2006.

In the case of a severable contract, each instalment constitutes a separate contract and extension in delivery period, if needed is to be done for each installment separately. If goods are accepted after expiry of the delivery date of a particular installment without extension in delivery period being given with reservation of right to liquidated damages etc., the purchaser will not be legally entitled to claim the liquidated damages etc.

Therefore, in case of severable contract, the purchaser should watch delivery position of each installment as per the specified date for that installment, and, whenever necessary, extend the corresponding date for the installment in question or cancel that installment, in which there is delay in supply.

3.10 Delay in Supplies for which Supplier is not responsible

Normally, in the following circumstances, the contractual delivery period needs to be re-fixed to take care of the lost period, without imposing any penalty to the supplier.

i) Cases where the manufacture of stores is dependent on the approval of the advance sample and delay occurs in approving the sample though submitted by the supplier in time.

ii) Where extension in delivery period is granted on account of some omission on the part of the purchaser which affects the due performance of the contract by the supplier.

iii) Cases where the purchaser controls the entire production. The delivery cannot be re-fixed to make a contract a 'severable' contract without the specific agreement of the supplier, if the delivery originally stipulated in the contract was in the form of an 'entire' contract.

3.11 Force Majeure

Force Majeure means an event beyond the control of the supplier and not involving the supplier's fault or negligence and which is not foreseeable. Such events may include, but are not restricted to, acts of the purchaser either in its sovereign or contractual capacity, wars or revolutions, hostility, acts of public enemy, civil commotion, sabotage, fires, floods, explosions, epidemics, quarantine restrictions, strikes, lockouts, and freight embargoes.

If there is delay in performance or other failures by the supplier to perform its obligation under its contract due to event of a Force Majeure, the supplier shall not be held responsible for such delays/failures. If a Force Majeure situation arises, the supplier shall promptly notify the purchaser in writing of such conditions and the cause thereof within twentyone days of occurrence of such event. Unless otherwise directed by the purchaser in writing, the supplier shall continue to perform its obligations under the contract as far as reasonably practical, and shall seek all reasonable alternative means for performance not prevented by the Force Majeure event. If the performance in whole or in part or any obligation under this contract is prevented or delayed by any reason of Force Majeure for a period exceeding sixty days, either party may at its option terminate the contract without any financial repercussion on either side. There may be a Force Majeure situation affecting the purchase organization only. In such a situation the purchase organization is to take up with the supplier on similar lines as above for further necessary action.

3.12 Remedies to Purchaser for delay in Supply / Non-Supply for which Supplier is responsible

The purchaser has the following options depending upon the circumstances of the case:

i) Extend the delivery with imposing of liquidated damages and other denial clauses

ii) Forfeit the performance security

iii) Cancel the contract

iv) Impose other available sanctions/penalties

3.13 Liquidated Damages

There should be a suitable provision in the terms & conditions of the contract for claiming liquidated damages of appropriate amount from the supplier to take care of delays in supplies and performance, for which the supplier is responsible. Such recovery through liquidated damages should be without prejudice to the other remedies available to the purchaser under the terms of the contract. Depending on the nature and value of the goods to be ordered and the urgency of the requirement, a specific percentage of the delivered price of the delayed goods (or delayed services) for each week or part

thereof delay, is to be incorporated in the contract terms. Generally, the percentage is 0.5% per week or part thereof. There should also be an appropriate maximum limit of such deduction, to be shown as a specific percentage of the contract value of delayed supplies/services and incorporated

in the contract terms. This percentage is generally 10%. Any lower ceiling should be clearly justified while formulating the contract.

3.13.1 Token Liquidated Damages.

There may be situations when charging full Liquidated Damages may not be justified as the reasons for delay in delivery by the supplier may be largely due to circumstances well beyond under his control but nevertheless these may not considered adequate to waive off liquidated damages altogether or there may be such deficiencies in service for which quantification may not be feasible and no other remedy may be available. In such cases, at the sole discretion of the purchaser, Token Liquidated Damages up to 10% of the normal Liquidated Damages may be imposed by the Competent Financial Authority with the approval. Stipulations to this effect, prescribing the kind of deficiencies and scale of Token Liquidated Damages chargeable should be clearly brought out in the tender documents. This safeguard should be consistent with the provisions of Performance Security

3.14 Extension of Delivery Period

If the supplier is unable to complete the supply within the stipulated delivery period for which the supplier is responsible, it (supplier) is required to request for extension of delivery period.

If the purchaser agrees to extend the contractual delivery schedule, the same may be done by issue of an amendment to the contract with suitable denial clauses and with imposition of liquidated damages for delay.

The amendment letter is to mention, *inter alia* that, in addition to imposition of liquidated damages, no extra price or additional cost for any reason whatsoever beyond the contractual cost will be paid to the supplier for the delayed supply; at the same time, if for any reason, whatsoever the cost of the goods to be supplied/services to be performed by the supplier decreases that benefit will be passed on to the purchaser. Supplier's unconditional acceptance of the amendment by a specified date is to be watched and if the supplier does not agree to accept the amendment letter, further action is to be taken against the supplier in terms of the contract.

3.15 Performance Notice

A situation may arise where the supply/services has not been completed within the stipulated period due to negligence / fault of the supplier; however the supplier has not made any request for extension of delivery period but the contracted goods/services are still required by the purchaser and the purchaser does not want to cancel the contract at that stage. In such a case, a Performance Notice (also known as Notice-cum-Extension Letter) may be issued to the supplier by suitably extending the delivery date and by imposing liquidated damages with denial clauses etc. on identical lines as above.

Supplier's acceptance, etc. of the performance notice and further action thereof should also be processed in the same manner as mentioned above. The text of the Performance Notice will be on similar lines to the model extension letters with suitable modifications as required.

3.16 Despatch of Goods after expiry of Delivery Period

As per the contract terms, the supplier is not to supply the goods when there is no valid delivery period. In case the supplier makes any supply after expiry of delivery period, the purchaser/consignee can reject the supplies and inform the supplier accordingly; the purchaser shall also have the right to cancel the contract (w.r.t. unsupplied goods) in terms of the contract. If, however, the purchaser / consignee requires the goods (which has been supplied after expiry of the delivery period), the purchaser may accept the goods and issue a delivery extension letter with usual LD clause and denial clauses, as mentioned earlier, to regularize the transaction.

3.17 Correspondence with the Supplier after Breach of Contract

The purchaser or its authorized representative is not to enter into correspondence after expiry of the delivery date stipulated in the contract because such a correspondence will make the contract alive. This situation will not allow the purchaser to cancel the contract straight away without first serving a performance notice to the supplier.

However, even after expiry of the delivery period of the contract, the purchaser may obtain information regarding past supplies etc. from the supplier, simultaneously making it clear to the supplier that calling of such information is not intended to keep the contract alive and it does not amount to waiving the breach and that it is without prejudice to the rights and remedies available to the purchaser under the terms of the contract.

3.18 Cancellation of Contract for Default

The purchaser may, without prejudice to any other remedy for breach of contract, by written notice of default sent to the supplier, terminate the contract in whole or in part:

a) If the supplier fails to deliver any or all of the stores within the time period(s) specified in the contract, or any extension thereof granted by the Purchaser; or

b) If the supplier fails to perform any other obligation under the contract within the period specified in the contract or any extension thereof granted by the purchaser.

In the event the purchaser terminates the contract in whole or in part; the purchaser may take recourse to any one or more of the following action.

i) the Performance Security is to be forfeited;

ii) the purchaser may procure, upon such terms and in such manner as it deems appropriate, stores similar to those undelivered, and the supplier shall be liable for all available actions against it in terms of the contract.

iii) however, the supplier shall continue to perform the contract to the extent not terminated.

Before cancelling the contract and taking further action, it may be desirable to obtain legal advice from the Legal Wing of the Ministry/Department or from the Ministry of justice.

3.19 Termination of Contract for insolvency

If the supplier becomes bankrupt or otherwise insolvent, the purchaser may, at any time, terminate the contract, by giving written notice to the supplier, without compensation to the supplier provided that such termination will not prejudice or affect any right of action or remedy which has accrued or will accrue thereafter to the purchaser.

3.20 Termination of Contract for Convenience

After placement of contract, there may be some unforeseen situation compelling the purchaser to cancel the contract. In such a case, the purchaser is to send a suitable notice to the supplier for cancellation of the contract, in whole or in part, for its (purchaser's) convenience, *inter alia*, indicating the date with effect from which the termination is to become effective.

Depending on the merits of the case, the purchase organization may have to suitably compensate the supplier on mutually agreed terms for terminating the contract. Suitable provisions to this effect are to be incorporated in the tender document as well as in the resultant contract.

4.0 CONCLUSION

Sometimes it becomes necessary for the purchase organization to conduct type test, acceptance test or special test at outside laboratories, when facilities for these tests are not available in-house with the supplier or carrying out of confirmatory tests is considered desirable before accepting the goods. Ministry/Department should draw up a list of approved laboratories for this purpose, to whom the samples drawn from the lots offered by the supplier can be sent for tests. The list should also contain approved laboratories, which can be used as referral/appellate laboratories for retest, when samples tested at one laboratory are decided to be re-tested.

5.0 SUMMARY

Evaluation of tenders is one of the most significant areas of Purchase Management. The entire process of tender evaluation and placement of contract must be transparent. In this unit we have extensively discussed the issues relating to the purchased goods delivery Period, terms of delivery, transportation, transit insurance, delay in supply, cancellation of contract. Depending on the terms of delivery and the projected requirement, all the applicable components of the costs, as quoted in the responsive tenders, are to be added to work out the ultimate evaluated costs of the tenders.

6.0 TUTOR MARKED ASSIGNMENT

Under what condition may a contract be terminated in whole or in part?

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UNIT 1 THE PURCHASING FUNCTION...1

Content

4.0 INTRODUCTION

Every Ministry / Department spends a sizeable amount of its budget for purchasing various types of goods to discharge the duties and responsibilities assigned to it. It is imperative that these purchases are made following a uniform, systematic, efficient and cost effective procedure, in accordance with the relevant rules and regulations of the Government. The Ministries / Departments have been delegated powers to make their own arrangements for procurement of goods under the Delegation of Financial Power Rules, which have to be exercised in conformity with the orders and guidelines issued by competent authorities coverings financial, vigilance, security, safety, countertrade and other regulatory aspects. Without purporting to be a comprehensive compendium of all statutory provisions, rules, regulations, orders and guidelines on the subject of public procurement, this Manual is intended to serve as a portal to enter this vast area and draw attention to basic norms and practices governing public procurement.

5.0 OBJECTIVES

At the end of studying this unit, you should be able to:

h) Comment on the issues leading to the changes in the role of purchasing over time

i) Define the following key terms: i purchasing; ii Procurement; iii Supply chain management; iv Materials Management.

j) Discuss the evolution of sustainable Purchasing Practices

k) Identify and explain the several major types of purchasing managers, buyers, and purchasing agents

l) Outline the functions of purchasing department

m) Distinguish and explain the objectives of purchasing can be viewed from three levels

n) List out the advantages of effective procurement

6.0 THE PURCHASING FUNCTION

3.1 New Angles to Purchasing

In recent years the purchasing and materials function have undergone a complete re-evaluation by business management. Materials management is sometimes described as 'the last goal line' for business manager. Indeed, it is among the last of the specialized business function to be centralized and given the responsibility and the authority for making major contribution to profits. Yet progress in this area of business management is just beginning.

In most business operations today, the cost of materials is the last remaining cost that is truly variable-all other major costs are either fixed or tend to be semi-fixed. Hence, a reduction in the cost of materials per se clearly offers an unusual opportunity for profit improvement. When one consider that materials cost in a typical manufacturing firm represents approximately 50 percent of total cost, the opportunity for profit improvement in the materials area is virtually impossible to match in any other area of business operation.

To date, only most progressive manufacturing firms realize that materials availability, purchasing specifications, fabrication cost, and distribution cost are all factors which impinge on total materials cost. These progressive firms also realise that all materials cost factors must be coordinated and controlled by a systems-oriented materials management department if total materials cost is to be optimized. Regrettably, most manufacturers still have to learn over forty years ago; (1) buying well is as selling well and (2) even the most capable sales efforts cannot compensate for poor purchasing specifications.

Fundamental economic reasons such as those noted above couple with business growing recognition of the superiority of the systems approach to management made possible by continuing advances in electronic data processing, are what essentially guarantee continued development and utilization of materials management.

Once we start to see purchasing as a business process in which many are involved rather than a standalone specialized function, we can start to talk the language of business and leave behind those parochial attitudes which so often act as barriers to getting the job done to maximum advantage.

The debate is now less about "who does what" and more about "ensuring what all is done well". At the same time the role of the purchasing professional throughout the revenue purchase portfolio is changing away solely an administrative 'doing' activity and more to one of providing consultancy service to the purchasing process. If is hoped that this guide will not just end as a another fad but will set out to upgrade and materials management processes.

3.2 Purchasing and Terminologies Defined

Part of the problem stems from the lack of a clear definition about the nature and role of purchasing within organisations. The terms purchasing and procurement are used interchangeable and there is often reference to materials management, logistic, etc. It may therefore be helpful to starting by clarifying some of these terms and concept. ***Purchasing may be defined as follows:***

> *The process by which an individual, a company (or other organisation) contracts with third parties to obtain the goods and services required to fulfil its business objectives in the most timely and cost-effective manner.*

Procurement

Procurement is a term originated by the Armed forces to define one of several supply functions involved in logistic. In the broadest sense, the Armed Forces define "procurement" as including the whole process whereby all classes of resources (people, material, facilities and services) required by the Armed Forces are obtained. Although the term "procurement" originated in military organisation, it has for many years also been adopted and used by American Industry. It is even included in the title of a well-known textbook. In scope, procurement's industrial meaning parallels its military meaning. In both settings, procurement encompasses a wider range of supply activities than does purchasing alone. But for the purpose of this book, *Procurement* is defined as being broader in scope than "purchasing" and includes activities of *strategic* relevance, such as sourcing, negotiating with suppliers and coordination with R&D.

Supply Chain Management

One only need consider the recent scandals surrounding tainted pet food and toys to see how disastrous "supply chain" mistakes can be not only for the purchaser, but also sometimes for an entire country.
A supply chain has been defined as "a network of facilities that procure raw materials, transform them into intermediate goods and then final products, and deliver the products to customers through a distribution system." The management of such a network requires mastery of optimization logistics, or the specific quantity of a good needed at a particular time and price. Clearly, relationships with suppliers that make up these networks are a central component of successful supply chain management. **Supply Chain Management** *(SCM)* is the broadest term mentioned so far. *It includes all of the above and is defined as the planning, steering and controlling of the whole flow of materials and services in a network of collaborating companies.*

Materials Management

Materials management, as practiced in business todady, can be defined as a confederacy of traditional materials activities bound by a common idea – the idea of an integrated management approach to planning, acquisition, conversion, flow and distribution of production materials form the raw-materials state to the finished-product state.

The materials management concept advocates the assignment of all major activities, which contribute to material's cost to a single materials management department. This include the primary responsibilities which are generally found in the purchasing department, plus all other major procurement responsibilities, including inventory management, traffic, receiving, warehousing, surplus and salvage and frequently production planning and control. Some companies also include customer service, scheduling, shipping, materials handling and physical distribution in their definition of materials management.

The specific form of material organisation most appropriate for one company may not be the best form for another company, a brief discussion of two materials activities will illustrate why the unique nature of a specific firm's ;operating activities influences its form of material organisation so heavily. Assume that a plant purchases all the parts, components and subassemblies for the product it manufactures. In this situation, if production were uniform, the production planning schedule and the purchasing schedule would be similar or identical.

Consequently, for this firm to achieve optimal materials and cost control production control should realistically be included in the materials management department. Assume now that a plant manufactures all the parts, components, and subassemblies that are used in turning out its product. In this situation, there may be very little similarity between the production planning and purchasing schedules. Therefore, in this firm, a strong case could be made for locating production control within the production department.

In practice, the theoretical extremes discussed above seldom exist. For most firms the production planning and purchasing schedules overlap significantly. Unfortunately, this frequently produces a continuing source of conflict.

One of the paramount advantages of materials management is that it forces coordination between purchasing and production control. Purchasing and production controls are both responsible to for the on-time delivery of production materials. Division of this authority between two different operating units inevitably led to conflict. When materials do to not arrive on time, production control is seldom satisfied to work through the purchasing department. Frequently, production control personnel proceed to expedite the materials directly with thee supplier. Since the expediting of purchased materials and negotiation with suppliers are basic purchasing responsibilities, conflicts ensues. Such conflict is resolved much more easily when production control and purchasing report to a single boss-the materials manager.

3.3 Evolution of Sustainable Purchasing Practices

In the context of a weak business case and the uneven distribution of power in the chain, sustainable purchasing practices have in the main emanated from experiences of various alternative trading models. These range from private sector schemes in response to market demands, to organisations that have a primary concern for producers rather than consumers, and research institutes and donor development agencies. Probably the most widely understood and popular approach is Fair Trade, particularly the standards and certification systems developed by the Fair-trade Labelling Organisation (FLO) and the practices of Alternative Trading Organisations (ATOs).

FLO aims to improve the conditions of trade for organisations of smallholder producers of tropical commodities by specifying the conditions for Fair-trade production (for both small scale producer organisations and 'conditions of hired labour') and importantly trade certification. Fair-trade standards focus on the trading relationship, covering contractual and price issues. ATOs such as Twin Trading and Tradecraft adopt a partnership approach and aim to connect producers and customers through direct relationships, increasing market knowledge, and adding greater value to the primary product.

A number of standards practices were sets for producers based on environmental, social, and economic criteria, assessed by an independent auditor (at producers' cost), to determine which producers achieve preferred supplier status. Those who meet the sustainability requirements accrue a better deal for their product through the receipt of 'outright prices' negotiated directly between co-operatives, private purchase, direct purchase, and long-term contracts of 3-5 years.

The sustainable purchasing practices outlined in Table 1 are ways in which interventions or changes in the current system can address the issue of the distribution of wealth and benefits in the product market. One thing that was clearly evident from the initiatives investigated was the wide range of companies and organisations who in various ways have demonstrated recognition of the need to address issues in commodity supply chains by adopting some of these practices.

The practices and perceived benefits in Table 1 are drawn from a number of sources, including Fair-trade principles, and also elements from recent policy-focused reports on responsible purchasing such as Tradecraft (2006). They represent a set of measures to both shift balances of power in trading relations to ensure that producers appropriate a greater share of margins from the cocoa value chain, and to build sustainability in supply through the employment of longer term strategies that provide enablers such as access to credit, market information, and contracts that commit beyond one season.

Sustainable Purchasing Practice	Perceived Benefit/s of Adoption
'Fair' share of the export price of cocoa to return to the smallholder farmer.	To cover costs of production and provide a sustainable income.[10]
Longer term contractual commitments.	Assist production planning and reduce volatility in prices.
Direct relationships.	Build trust and stability in the chain. Reduce the number of 'middlemen'.
Improved access to affordable credit and pre-harvest finance.	Improve cash flow of farmers to purchase agricultural inputs and cover harvest expenses.
Timely payments and communication with mutually agreed payment terms.	Greater trust and clarity; reduce uncertainty at end of harvest.
Differential pricing and community premium payments.	Creation of greater local capacity through small-scale investments in appropriate technology, diversification initiatives, and community development projects.

Table 1: The sustainable purchasing practices

3.4 Purchasing Managers, Buyers, and Purchasing Agents

Purchasing managers, *buyers*, and *purchasing agents* buy a vast array of farm products, durable and nondurable goods, and services for companies and institutions. They attempt to get the best deal for their company—the highest quality goods and services at the lowest possible cost. They accomplish this by studying sales records and inventory levels of current stock, identifying foreign and domestic suppliers, and keeping abreast of changes affecting both the supply of, and demand for, needed products and materials. Purchasing professionals consider price, quality, availability, reliability, and technical support when choosing suppliers and merchandise. To be effective, purchasing professionals must have a working technical knowledge of the goods or services to be purchased.

There are several major types of purchasing managers, buyers, and purchasing agents. *Wholesale and retail buyers* purchase goods, such as clothing or electronics, for resale. Purchasing agents buy goods and services for use by their own company or organization. *Purchasing agents and buyers of farm products* purchase goods such as grain, Christmas trees, and tobacco for further processing or resale. Purchasing managers usually handle more complicated purchases and may supervise a group of purchasing agents. Purchasing professionals employed by government agencies or manufacturing firms usually are called purchasing directors, managers, or agents; sometimes they are known as contract specialists. Purchasing professionals in government place solicitations for services and accept bids and offers through the Internet. Some purchasing managers, called contract or supply managers, specialize in negotiating and supervising supply contracts.

Purchasing specialists who buy finished goods for resale are employed by wholesale and retail establishments, where they commonly are known as buyers or *merchandise managers*. Wholesale and retail buyers are an integral part of a complex system of distribution and merchandising that caters to the vast array of consumer needs and desires. Wholesale buyers purchase goods directly from manufacturers or from other wholesale firms for resale to retail firms, commercial establishments, and other organizations. In retail firms, buyers purchase goods from wholesale firms or directly from manufacturers for resale to the public.

Buyers largely determine which products their establishment will sell. Therefore, it is essential that they have the ability to predict what will appeal to consumers. If they fail to purchase the right products for resale, buyers jeopardize the profits and reputation of their company.

They keep track of inventories and sales levels, check competitors' sales activities, and watch general economic conditions to anticipate consumer buying patterns. Buyers working for large and medium-sized firms usually specialize in acquiring one or two lines of merchandise, whereas buyers working for small stores may purchase the establishment's complete inventory.

Evaluating suppliers is one of the most critical functions of a purchasing manager, buyer, or purchasing agent. Many firms now run on a lean manufacturing schedule and use just-in-time inventories so any delays in the supply chain can shut down production and potentially cost the firm its customers. Purchasing professionals use many resources to find out all they can about potential suppliers.

The Internet has become an effective tool for searching catalogs, trade journals, industry and company publications, and directories. Purchasing professionals attend meetings, trade shows, and conferences to learn of new industry trends and make contacts with suppliers. They often interview prospective suppliers and visit their plants and distribution centers to assess their capabilities. It is important to make certain that the supplier is capable of delivering the desired goods or services on time, in the correct quantities, and without sacrificing quality. Once all of the necessary information on suppliers is gathered, orders are placed, and contracts are awarded to those suppliers who meet the purchaser's needs. Most of the transaction process is now automated through use of the Internet.

Purchasing professionals often work closely with other employees in a process called “team buying.” For example, before submitting an order, the team may discuss the design of custom-made products with company design engineers, the problems involving the quality of purchased goods with production supervisors, or the issues in shipping with managers in the receiving department. This additional interaction improves the quality of buying by adding different perspectives to the process.

Work environment. Most purchasing managers, buyers, and purchasing agents work in comfortable offices. They frequently work more than the standard 40-hour week, because of special sales, conferences, or production deadlines. Evening and weekend work also is common before holiday and back-to-school seasons for those working in retail trade. Consequently, many retail firms discourage the use of vacation time during peak periods.

3.5 The Function of Purchasing Department

Apart from purchasing per se, a purchase department would have several complementary activities. Menon (1993) stated some of the important ones to include:

1) Market research for new materials and development of new source of supply.

2) Follow-up with suppliers to ensure proper delivery.

3) Quality assurance in respect of supplies made by vendors, (this includes supplier education, visiting the vendor’s factor to ensure in-process quality assurance).

4) Inspection of materials for quality in order to that the specifications are complied with.
5) Development of proper and streamlined systems and procedures relating to the purchasing function to ensure that work is carried out efficiently and at the lowest reasonable operating cost.
6) Co-ordination with in other functions with the materials department like transportation, receiving, store-keeping, inventory control, accounting etc.
7) Co-ordination with the production, sales and finance departments regarding alteration in production schedules or delivery rates, or changes in materials, product or packaging specification.

3.6 Objective of Purchasing

According to Dobler et al (1996), the objectives of purchasing can be viewed from three levels.
i) A very general managerial level,
ii) A more specific functional or operational level, and
iii) A detailed levels at which precise strategic buying plans are formulated.

• From a top managerial perspective, the general objectives have traditionally been expressed as the five rights that management expects the department to achieve i.e. the acquisition of materials: of the right quality, from the right price. In practice, however, the department can rarely fulfill all these equally, because in some buying situations, conflicts inherently exist between some of the objectives. So usually, some trade-offs must be made. From a practical point of view, supply personnel seek a reasonable balance among these elements of the purchasing mix.

• From an operating or functional perspective, an objective broadly becomes a developed set of statements that provide practical and useful targets for decision-making purposes. In these cases, the following broad statement of objectives is suggested:

1) To support company operations with an uninterrupted flow of materials and services. This is the most fundamental of all the purchasing and supply objectives. In a logical sense, this is a key reason for the existence of the department.
2) To buy competitively and wisely. Buying competitively keeps the buyers on the edge of the companies' activities. Buyers should know what's going on in the outside world. They must keep abreast of the forces of demand and supply that regulate price and material availability. They must be aware of the best practices and the latest developments and ultimately buying to the company's best advantage.

3) To keep inventory investment and inventory losses at a practical minimum. The purchasing job is to achieve a reasonable balance between the required level of inventory to support operations and the cost of carrying the inventory.
4) To develop effective and reliable sources of supply.
5) To develop good relationships with the supplier's community and continuing relationships with active suppliers.
Good relationship with suppliers is imperative, and good relationships with potential suppliers are invaluable. The achievement of the objective number 4 above, on a continuing basis, is virtually impossible if mutually satisfactory continuing relationships are not maintained.
6) To maintain sound co-operative relationships with other departments, providing information and advice as necessary to ensure the effective operation of the organisation as a whole.
7) To develop staff, policies, procedures and organisation to ensure the achievement of the foregoing objectives.

It is a truism, however, that the objective of the purchasing department will vary a great deal, depending upon the organisation's policy, complexity, size, operations, etc.
The third level focuses on the detailed objectives that are developed when precise buying plans are made (usually annually) for each major category of materials the firm uses in its operations. These precise set of objectives for each material typically varies because the usage requirements, the operating conditions, and the markets in which each material is purchased usually are different.

3.7 Advantages of Effective Purchasing

Deriving from the above objectives, we might identify the following as being the principal benefits to be gained from the effective management of the procurement process:
(1) Lower prices of materials and items used
(2) Faster inventory turnover
(3) Continuity of supply
(4) Reduced replenishment lead times
(5) Reduced transportation cost
(6) Reduced materials obsolescence
(7) Improved vendor relationships
(8) Better control of quality
(9) Effective administration and immunisation of organisation effort

(10) Maintenance of adequate records and provision of information for the operations managers.

SELF ASSESSMENT EXCERCISE What operational or functional level objective should Purchasing seek to achieve as a business function?

4.0 CONCLUSION

Clearly, the purchase of items and material has relevance in all types of organisation or operating system, since in all such systems there will be some dependence upon the use of physical items. Whilst the principles and objectives of purchasing might also be applied in the acquisition of labour, capital, etc. the purchasing process is concerned primarily with obtaining physical items for use in, and conversion through, the operating system. Most operating system requires such items. Hospitals for example require a regular reliable supply of consumable items such as medicines, sterile equipment, etc. Transport operations are dependent upon adequate supply of consumable materials such as fuel, tyres, etc. Supply organisations naturally are dependent upon an adequate, reliable and efficient supply of those items which are to be passed to customers, whilst manufacturing organisations are entirely dependent upon the supply of consumable and non-consumable materials and items.

5.0 SUMMARY

Purchasing is one of the basic functions common to all types of business enterprises. These functions are so basic because no business can operate without them. As a business function and in terms of naira spent, purchasing is far the biggest spending department of any manufacturing company. Purchased materials consume over half of a manufacturing firm’s sales revenue. It is however generally agreed that it is easer to buy well than it is to sell well. Wise purchasing can reduce operational costs appreciably and also improve profitability

6.0 TUTOR-MARKED ASSIGNMENT

There are several major types of purchasing managers, buyers, and purchasing agents. Who are these people and what do they do?

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UNIT 2 PURCHASING GUIDELINES, TERMS AND TERMINOLOGIES....13

Content

1.0 INTRODUCTION

In many organisations purchasing remains the least understood and most ineffectively managed of all the business process. Quite apart from the monetary issue and deviating effect on profit forecasts, mistakes can consequently threaten the viability of the enterprise by allowing costs to rise or delaying the introduction of new products into the market place, leading in turn to a loss of competitiveness. Yet management persist with outdated and inappropriate concepts. Why should this be so and what can be done about it? In this section, you will be equipped with the skill of using different terms and terminologies and an appreciation of the basic guidelines in making purchases.

2.0 OBJECTIVE

At end of studying this unit, you should be able to;

1 Use freely and correctly the purchasing terms and terminologies
2 Explain standard tender enquiry documents
3 Outline and comment on the guidelines for public procurement
4 Discuss the fundamental principles of public buying

3.0. PURCHASING GUIDELINES, TERMS AND TERMINOLOGIES

3.1 PURCHASING TERMS AND TERMINOLOGIES

3.1.1 Buy Back Offer

When it is decided with the approval of the competent authority to replace some existing old goods with their newer and better versions/substitutes, the department may trade the existing old goods while purchasing the new ones.

For this purpose, suitable clauses are to be incorporated in the tender enquiry document so that the interested tenderers formulate and submit their tenders accordingly. Provision should also be kept in the tender documents to permit the interested tenderers to inspect the old goods to be traded through this transaction.

Appropriate provision should also be kept in the tender document allowing the purchase organization to reserve its right to trade or not to trade the old goods while purchasing the new ones and the tenderers are to be asked to frame their quotations accordingly covering both the options. Depending on the value and condition of the old goods to be traded, the time frame for as well as the mode of handing them over to the successful tenderer should be decided and relevant details in this regard suitably incorporated in the tender document.

3.1.2 Maintenance Contract

3.1.2 (a) Some goods, especially sophisticated equipment and machinery need proper maintenance for trouble free service. For this purpose, the purchase organization may enter into maintenance contract. It must however be kept in mind that maintenance contract is to start after the expiry of the warranty period, during which period the goods are to be maintained free of cost by the supplier.

3.1.2 (b) Maintenance contract may be entered into either with the manufacturer/supplier of the goods or with a competent and eligible firm, not necessarily the manufacturer/supplier of the goods in question. The purchase organization should decide this aspect on case to case basis on merit. If the maintenance contract is to be entered into with the supplier of the goods, then suitable clauses for this purpose are to be incorporated in the tender enquiry document itself and while evaluating the offers, the cost component towards maintenance of the goods are also to be added in the evaluated tender value on overall basis to decide the inter se ranking of the responsive tenderers. An equipment with a lower quoted price may carry a higher maintenance liability. Therefore, total cost on purchase and maintenance of the equipment over its projected lifecycle should be assessed to consider its suitability for purchase.

However, if the maintenance contract is to be entered into with a competent and eligible supplier separately, then a separate tender enquiry is to be floated for this purpose and tenders evaluated and ranked accordingly for placement of maintenance contract. Here, the supplier of the goods may also quote and its quotation, if received, is to be considered along with other quotations received. While evaluating the tenderers for maintenance of goods covering a longer period (say, more than one year), the quoted prices pertaining to maintenance in future years are to be discounted to the net present value (NPV) as appropriate for comparing the tenders on equitable basis and deciding the lowest evaluated responsive tender.

3.1.2 (c) The details of the services required for maintenance of the goods, the required period of maintenance and other relevant terms & conditions including payment terms are to be incorporated in the tender enquiry document. The terms of payment for the maintenance service will depend on the nature of the goods to be maintained as well as the nature of the services desired. Generally, payment for maintenance is made on half-yearly or quarterly basis.

3.1.2 (d) A suitable provision should be incorporated in the tender enquiry document and in the resultant maintenance contract indicating that the prices charged by the maintenance contractor should not exceed the prevailing rates charged by it from others for similar services. While claiming payment, the contractor is also to give a certificate to this effect in its bill.

3.1.2 (e) If the goods to be maintained are sophisticated and costly, the tender enquiry document should also have a provision for obtaining performance security. The amount of performance security will depend on the nature of the goods, period of maintenance etc. It generally varies from 2.5 % to 5% of the value of the equipment to be maintained.

3.1.2 (f) Sometimes, the maintenance contractor may have to take the goods or some components of the goods to its factory for repair etc. On such occasions, before handing over the goods or components, suitable bank guarantee is to be obtained from the firm to safeguard purchaser's interest.

3.1.2 (g) Sometimes, during the tenure of a maintenance contract, especially with a longer tenure, it may become necessary for the purchase organization to withdraw the maintenance contract due to some unforeseen reasons. To take care of the same, there should be a suitable provision in the tender document and in the resultant contract. A model clause to this effect is provided below:

> "The purchaser reserves its right to terminate the maintenance contract at any time without assigning any reason. The contractor will not be entitled to claim any compensation against such termination. However, while terminating the contract, if any payment is due to the contractor for maintenance services already performed in terms of the contract, the same would be paid to it as per the contract terms".

Depending on the cost and nature of the goods to be maintained, suitable notice period for such cancellation to come into effect is to be provided in the documents.

3.1.3 Turnkey Contract

A turnkey contract is a mix of goods contract and works contract. Generally, in the tender enquiry documents for a turnkey contract, the purchase organization specifies the performance and output required from the plant proposed to be set up and broadly outlines the various parameters it visualizes for the desired plant. The inputs and other facilities, which the purchase organization will provide to the contractor, are also indicated in the tender enquiry document. The contractor is to design the plant and quote accordingly. The responsibility of the contractor will include supplying the required goods, machinery, equipment etc. needed for the plant; assembling, installing and erecting the same at site as needed; commissioning the plant to meet the required output etc., as specified in the tender enquiry documents. While entering into a turn-key contract, Ministry/Department is to follow the relevant instructions prescribed in the Purchase Manual for Goods as well as in the Works Manual.

3.1.4 Disposal of Surplus Goods

With the passage of time, many of the goods purchased by the Ministries/Departments become unserviceable or obsolete. Such goods are classified as surplus goods. The Ministries/Departments should dispose off such surplus goods at the earliest, to avoid unnecessary inventory carrying cost, decrease in resale price of those goods etc.

3.1.5 Computerization of Purchase Work

Every Ministry/Department should attempt to computerize all the areas of purchase management to the maximum extent possible and develop a suitable package for these purpose through a competent IT firm. This will ultimately result in better efficiency, more speed in performing the duties and, also, reduction in the overall expenditure.

3.1.6 Training

Purchase management is a specialized subject and, therefore, the entrusted with purchase work should be adequately trained at the entry level itself to avoid mistakes in tender evaluation, placement of contract, contract management etc., because any mistake in public procurement may cause financial repercussions, operational hold-ups, and unwarranted legal complications for the Ministries / Departments.

In addition to entry level training, the purchase officials should also be sent for in-service training periodically to keep them abreast with the changing scenario and latest techniques of Purchase Management taking place within as well as outside the country.

3.1.7 Beyond the Manual

The important and significant areas of Public Buying have been covered in this Manual. A situation may, however crop up in a purchase case for which no solution may be readily available in this Manual. In such a situation, the Ministries/Departments may seek advice and guidance from the Central Purchase Organization (e.g.DGS&D) and/or from the Ministry of Law.

3.1.8 Definition of Goods

The term 'goods' used in this Manual applies generally to all articles, material, commodities, livestock, furniture, fixtures, raw material, spares, instruments, machinery, equipment, industrial plant etc. purchased or otherwise acquired for the use of Government but excluding books, publications, periodicals, etc. for a library.

3.2 Standard Terminology and Abbreviations

Standard terminology has been adopted in this book. In certain areas, there may be two or more widely used terminologies bearing the same meaning as mentioned below:

i) Tender, Bid, Quotation. (Meaning: offer received from a supplier)

ii) Tenderer, Bidder. (Meaning: an entity who seeks to supply goods by sending tender/bid)

iii) Tender Enquiry Document, Tender Document, Bidding Document. (Meaning: a detailed document issued by the purchaser specifying his needs and the requirements that a potential tenderer/bidder must meet).

iv) Notice Inviting Tenders, Invitation for Bids (Meaning: advertisement containing brief details of the requirement).

v) Earnest Money Deposit, Bid Security. (Meaning: monetary guarantee furnished by a tenderer along with its tender)

vi) Security Deposit, Performance Security. [Meaning: monetary guarantee furnished by the successful tenderer for due performance of the contract concluded with it.]

Standard Abbreviations have been used in this book. Some important abbreviations are listed below for ready reference:

ACASH	Association of Corporations and APEX Societies of Handlooms
A/T	Acceptance of Tender
ATI	Advertised Tender Enquiry
BG	Bank Guarantee
BL	Bill of Lading
CD	Custom Duty
CIF	Cost, Insurance & Freight
CIP	Carriage and Insurance Paid
CPSU	Central Public Sector Undertaking
DGS&D	Directorate General of Supplies & Disposals
DP	Delivery Period
ED	Excise Duty
EMD	Earnest Money Deposit
FAS	Free Alongside Ship
FM	Force Majeure
FOB	Free On Board
FOR	Free On Rail
INCOTERMS	International Commercial Terms
KVIC	Khadi Village Industries Commission
LC	Letter of Credit
LD-	Liquidated Damages
LPP	Last Purchase Price
LSI	Large Scale Industries
LTI	Limited Tender Enquiry

NSIC	National Small Scale Industries Corporation
NTH	National Test House
PO	Purchase Order
PSU	Public Sector Undertaking
RC	Rate Contract
RR	Railway Receipt
SO	Supply Order
SSI	Small Scale Industries
ST	Sales Tax
STI	Single Tender Inquiry
TPC	Tender Purchase Committee
VAT	Value Added Tax
WDO	Women's Development Organization

3.2.1 Standard Tender Enquiry Documents

The Ministries / Departments should use standard forms of tender enquiry documents and contracts in line with the extant rules, regulations, directives, procedures etc. A set of standard documents may be kept updated for this purpose by each office, broadly following the standard documents prescribed by higher authorities and customizing these standard templates to suit specific requirements. Supervisory authorities would prescribe the kind of alterations permitted in the standard templates and the cases where deviations from the standard provisions can be made with appropriate legal and financial advice.

3.3 GUIDDELINES FOR PUBLIC PROCUREMENT

Transparency, Competition, Fairness and Elimination of Arbitrariness Public buying should be conducted in a transparent manner to bring competition, fairness and elimination of arbitrariness in the system. This will enable the prospective tenderers to formulate competitive tenders with confidence. The following are some important measures to achieve the same and, thus, secure best value for money:

(a) The text of the tender document should be user-friendly, selfcontained, comprehensive, unambiguous, and relevant to the objective of the purchase. The use of terminology used in common parlance in the industry should be preferred.

(b) The specifications of the required goods should be framed giving sufficient details in such a manner that it is neither too elaborately restrictive as to deter potential tenderers or increase the cost of purchase nor too sketchy to leave scope for sub-standard supply. The specifications must meet the essential requirements of the user department. Efforts should also be made to use standard specifications, which are widely known to the industry.

(c) The tender document should clearly mention the eligibility criteria to be met by the tenderers such as minimum level of experience, past performance, technical capability, manufacturing facilities, financial position, ownership or any legal restriction etc.

(d) Restrictions on who is qualified to tender should conform to extant Government policies and be judiciously chosen so as not to stifle competition amongst potential tenderers.

(e) The procedure for preparing and submitting the tenders; deadline for submission of tenders; date, time & place of public opening of tenders; requirement of earnest money and performance security; parameters for determining responsiveness of tenders; evaluating and ranking of tenders and criteria for full or partial acceptance of tender and conclusion of contract should be incorporated in the tender enquiry in clear terms.

(f) Tenders should be evaluated in terms of the criteria already incorporated in the tender document, based on which tenders have been received. Any new condition, which was not incorporated in the tender document, should not be brought into consideration while evaluating the tenders.

(g) Sufficient time should be allowed to the tenderers to prepare and submit their tenders.

(h) Suitable provisions should be kept in the tender document allowing the tenderers reasonable opportunity to question the tender conditions, tendering process, and/or rejection of its tender and the settlement of disputes, if any, emanating from the resultant contract.

(i) It should be made clear in the tender document that tenderers are not permitted to alter or modify their tenders after expiry of the deadline for receipt of tender till the date of validity of tenders and if they do so, their earnest money will be forfeited.

(j) Negotiations with the tenderers must be severely discouraged. However, in exceptional circumstances, where price negotiations are considered unavoidable, the same may be resorted to, but only with the lowest evaluated responsive tenderer, and that too with the approval of the competent authority, after duly recording the reasons for such action.

(k) The name of the successful tenderer to whom the supply contract is awarded should be appropriately notified by the purchase organization for the information of general public, including display at notice board, periodical bulletins, website etc.

3.3.1 Efficiency, Economy and Accountability

Public procurement procedures must conform to exemplary norms of best practices to ensure efficiency, economy and accountability in the system. To achieve this objective, the following key areas should be taken care of:

(i) To reduce delays, each Ministry / Department should prescribe appropriate time frame for each stage of procurement; delineate the responsibility of different officials and agencies involved in the purchase process and delegate, wherever necessary, appropriate purchase powers to the lower functionaries with due approval of the competent authority.

(ii) Each Ministry / Department should ensure conclusion of contract within the original validity of the tenders. Extension of tender validity must be discouraged and resorted to only in absolutely unavoidable, exceptional circumstances with the approval of the competent authority after duly recording the reasons for such extension.

(iii) The Central Purchase Organizations should bring into the rate contract system more and more common user items, which are frequently needed in bulk by various Ministries / Departments.

The Central Purchase Organizations should also ensure that the rate contracts remain available without any break.

3.4 Fundamental Principles of Public Buying

It may be useful to refer to the following provisions in the General Financial Rules, 2005:

Rule 1► Fundamental principles of public buying

Every authority delegated with the financial powers of procuring goods in public interest shall have the responsibility and accountability to bring efficiency, economy, transparency in matters relating to public procurement and for fair and equitable treatment of suppliers and promotion of competition in public procurement. The procedure to be followed in making public procurement must conform to the following yardsticks :-

> *(i) the specifications in terms of quality, type etc., as also quantity of goods to be procured, should be clearly spelt out keeping in view the specific needs of the procuring organizations. The specifications so worked out should meet the basic needs of the organization without including superfluous and non-essential features, which may result in unwarranted expenditure. Care should also be taken to avoid purchasing quantities in excess of requirement to avoid inventory carrying costs;*
>
> *(ii) offers should be invited following a fair, transparent and reasonable procedure;*
>
> *(iii) the procuring authority should be satisfied that the selected offer adequately meets the requirement in all respects;*
>
> *(iv) the procuring authority should satisfy itself that the price of the selected offer is reasonable and consistent with the quality required;*

(v) at each stage of procurement the concerned procuring authority must place on record, in precise terms, the considerations which weighed with it while taking the procurement decision.

Rule 2► Authorities competent to purchase goods and their Purchase Powers

2.1 An authority which is competent to incur contingent expenditure may sanction the purchase of goods required for use in public service following the general procedure contained in this Manual.

2.2 A demand should not be split into small quantities for the sole purpose of avoiding the necessity of taking approval of the higher authority required for sanctioning the purchase of the original demand.

Rule 3► Purchase through a Central Purchase Organization

In case a Ministry / Department does not have the required expertise or manpower, it may send its indent to the Central Purchase Organization with the approval of its Secretary. The indent form to be utilized for this purpose will be as per the standard form evolved by the Central Purchase Organization.

Rule 4► Price Preference

As per the extant rules, when acceptable offers are received against an *ad-hoc* requirement of unreserved goods from various categories of suppliers, including Large Scale Sector, Public Sector Undertakings and Small Scale Sector, the offer from the Small Scale Sector, which is registered with National Small Industries Corporation (NSIC) or with Directorate General of Supply and Disposal (DGS&D) is entitled for price preference up to 15% over the offer of Large Scale Sector and 5% over the offer of Public Sector Undertaking, provided the offers under consideration are otherwise clear for acceptance in all respects.

(Example: The evaluated cost of the lowest acceptable offer, which is from a Large Scale Sector is =N=100/-. The evaluated cost of an acceptable offer from a Small Scale Unit, which is registered with NSIC / DGS&D is =N=115/-. This SSI is entitled to get the order at its quoted price).

However, the price preference admissible to the SSI unit is not mandatory. It is to be decided separately for each tender on merits of each case, in consultation with Finance, and a mention to that effect should be made in the Notice Inviting Tenders (NIT)/Request for Proposal (RFP). The price preference is accorded to the deserving SSI units as an incentive to grow; but it should not promote inflation, profiteering or misuse of SSI units as conduits. In case the SSI unit in view has established itself as a supplier of the required goods on competitive terms and enjoys advantage(s) over Large Scale Sector, no price preference need be considered.

Where the NSIC / State Development Corporations themselves quote on behalf of some SSI units, such offers will be considered as offers from SSI units registered with the DGS&D/NSIC. An SSI Unit will not get any price preference over another SSI Unit.

Price preference facility to SSI Units will, however, not apply to the procurement of all goods for example, drug items, medical and electro-medical equipment, requirements of defence, where inspection is to be carried out by the defence Inspection organization, items where technical competence, capacity and manufacturing facilities are required to be verified before placement of order and other similar goods. Before considering any price preference to Small Scale Sector, the purchase organization should check the latest directives in this regard for necessary action.

4.0 CONCLUSION

Appropriate provision should be kept in the tender document allowing the purchase organization to reserve its right to trade or not to trade the old goods while purchasing the new ones and the tenderers are to be asked to frame their quotations accordingly covering both the options. Depending on the value and condition of the old goods to be traded, the time frame for as well as the mode of handing them over to the successful tenderer should be decided and relevant details in this regard suitably incorporated in the tender document.

5.0 SUMMARY

In this unit we have different considered a number of terms and terminologies and an appreciation of the basic guidelines in making purchases. Standard terminology has been adopted in this book. In certain areas, there may be two or more widely used terminologies bearing the same meaning.

And finally, public procurement procedures must conform to exemplary norms of best practices to ensure efficiency, economy and accountability in the system.

6.0 TUTOR MARKED ASSIGNMENT

Public procurement procedures must conform to exemplary norms of best practices to ensure efficiency, economy and accountability in the system

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UNIT 3 GENERAL PRINCIPLES OF ENTERING INTO CONTRACTS.....24

Content

3.0 INTRODUCTION

The purchasing function comprises the essential activities associated with the acquisition of the materials, services, and equipment used in the operation of an organisation. During the early years, the purchasing function used to be handled in a reactive, staff support manner. Subsequently, it was conducted more professionally with a managerial emphasis. Management is said to involve getting a job done through people and central to the discussion of management are the managerial functions of planning, organising, directing and controlling. These functions are relevant regardless of the type of organisation or the level of management with which one is concerned. This unit exposes you to the issues involved in the management of contract particularly the general principles for contract.

2.0 OBJECTIVE

At the end of studying this unit, you should be able to;

1 Highlight and discuss the elementary legal practices that pertains to purchase of goods

2 Outline and explain in clear term the general principles that should be observed while entering into contracts

3.0 GENERAL PRINCIPLES OF ENTERING INTO CONTRACTS

3.1 Elementary Legal Practices

The elements and principles of contract law and the meaning and import of various legal terms used in connection with the contracts are available in the Company and Allied Matters decree of 1990 in Nigeria read with the Sale of Goods Act, 1930. Some of the salient principles relating to contracts are set out briefly in this unit.

3.1.1 **What is a Contract?**

The proposal or offer when accepted is a promise, a promise and every set of promises forming the consideration for each other is an agreement, and an agreement if made with free consent of parties competent to contract, for a lawful consideration and with a lawful object is a contract.

3.1.2 **Proposal or Offer:** When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of the other to such act or abstinence, he is said to make a proposal or offer. In a sale or purchase by tender, the tender signed by the tenderer is the proposal. The invitation to tender and instructions to tenderers do not constitute a proposal.

3.1.3 **Acceptance of the Proposal:** When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise.

3.1.4 **What agreements are contracts:** An agreement is a contract enforceable by law when the following are satisfied. A defect affecting any of these renders a contract un-enforceable.

(a) Competency of the parties

(b) Freedom of consent of both parties

(c) Lawfulness of consideration

(d) Lawfulness of object

3.2 Competency of Parties

Under law any person who has attained majority and is of sound mind or not debarred by law to which he is subject, may enter into contracts. It, therefore, follows that minors and persons of unsound mind cannot enter into contracts nor can insolvent person do so.

3.2.1 Categories of persons and bodies who are parties to the contract may be broadly sub-divided under the following heads: -

(a) Individuals

(b) Partnerships

(c) Limited Companies

(d) Corporations other than limited companies

(a) Contracts with Individuals: Individuals tender either in their own name or in the name and style of their business. If the tender is signed by any person other than the concerned individual, the authority of the person signing the tender on behalf of another must be verified and a proper power of attorney authorizing such person should be insisted on. In case, a tender is submitted in a business name and if it is a concern of an individual, the constitution of the business and the capacity of the individual must appear on the face of the contract and the tender signed by the individual himself as proprietor or by his duly authorized attorney.

(b) Contracts with Partnerships: A partnership is an association of two or more individuals formed for the purpose of doing business jointly under a business name. It is also called a firm. It should be noted that a partnership is not a legal entity by itself, apart from the individuals constituting it. A partner is the implied authority to bind the firm in a contract coming in the purview of the usual business of the firm. The implied authority of a partner, however, does not extend to enter into arbitration agreement on behalf of the firm. While entering into a contract with partnership firm care should be taken to verify the existence of consent of all the partners to the arbitration agreement.

(c) Contracts with Limited Companies: Companies are association of individuals registered under Companies Act in which the liability of the members comprising the association is limited to the extent of the shares held by them in such companies. The company, after its incorporation or registration, is an artificial legal person which has an existence quite distinct and separate from the members of shareholders comprising the same. A company is not empowered to enter into a contract for purposes not covered by its memorandum of association; any such agreement in excess of power entered into the company is void and cannot be enforced.

Therefore, in cases of doubt, the company must be asked to produce its memorandum for verification or the position may be verified by an inspection of the memorandum from the office of the Registrar of Companies before entering into a contract. Normally, any one of the Directors of the company is empowered to present the company. Where tenders are signed by persons other than Directors or authorized Managing Agents, it may be necessary to examine if the person signing the tender is authorized by the company to enter into contracts on its behalf.

(d) Corporation other than Limited Companies: Associations of individuals incorporated under statutes such as Trade Union Act and Cooperative Societies Act are also artificial persons in the eye of law and are entitled to enter into such contracts as are authorized by their memorandum of association. If any contract has to be entered into with any one or such corporations or associations, the capacity of such associations to enter into contract should be verified and also the authority of the person coming forward to represent the said Association.

3.3 Consent of both Parties

Two or more persons are said to consent when they agree upon the same thing in the same sense. When two persons dealing with each other have their minds directed to different objects or attach different meanings to the language which they use, there is no agreement. The misunderstanding which is incompatible with agreement, may occur in the following cases: -

(a) When the misunderstanding relates to the identity of the other party to the agreement;

(b) When it relates to the nature or terms of the transactions;

(c) When it related to the subject matter of the agreement.

3.4 Free consent of both Parties

3.4.1 The consent is said to be free when it is not caused by coercion, undue influence, fraud, mis-representation or mistake. Consent is said to be so caused when it would not have been given but for the existence of coercion, undue influence, fraud, mis-representation or mistake. When consent to an agreement is caused by coercion, undue influence, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was caused. A party to a contract, whose consent was caused by fraud or misrepresentation may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representations made had been true.

3.4.2 In case consent to an agreement has been given under a mistake, the position is slightly different. When both the parties to an agreement are under a mistake as to a matter essential to the agreement, the agreement is not voidable but void. When the mistake is unilateral on the part of one party only, the agreement is not void.

3.4.3 Distinction has also to be drawn between a mistake of fact and a mistake of law. A contract is not void because it was caused by a mistake as to any law in force in India but a mistake as to law not in force in India has the same effect as a mistake of fact.

3.5 Consideration

Consideration is something which is advantageous to the promisor or which is onerous or disadvantageous to the promisee. Inadequacy of consideration is, however, not a ground avoiding the contract. But an act, forbearance or promise which is contemplation of law has no value is no consideration and likewise an act or a promise which is illegal or impossible has no value.

3.6 Lawfulness of object

The consideration or object of an agreement is lawful, unless it is forbidden by law or is of such a nature that if permitted, it would defeat the provisions of any law, or is fraudulent or involves or implies injury to the fraudulent property of another or the court regards it as immoral or opposed to public policy. In each of these cases the consideration or object of an agreement is said to be unlawful.

3.7 Communication of an Offer or Proposal

The communication of a proposal is complete when it comes to the knowledge of the person to whom it is made. A time is generally provided in the tender forms for submission of the tender. Purchaser is not bound to consider a tender, which is received beyond that time.

3.8 Communication of Acceptance

A date is invariably fixed in tender forms upto which tenders are open for acceptance. A proposal or offer stands revoked by the lapse of time prescribed in such offer for its acceptance. If, therefore, in case it is not possible to decide a tender within the period of validity of the offer as originally made, the consent of the tenderer firm should be obtained to keep the offer open for further period or periods.

3.8.1 The communication of an acceptance is complete as against the proposer or offerer, where it is put in the course of transmission to him, so as to be out of the power of the acceptor, and it is complete as against the acceptor when it comes to the knowledge of the proposer or offerer. The medium of communication in government contracts is generally by post and the acceptance is, therefore, complete as soon as it is posted. So that there might be no possibility of a dispute regarding the date of communication of acceptance, it should be sent to the correct address by some authentic foolproof mode like registered post acknowledgement due, etc.

3.9 Acceptance to be identical with Proposal

If the terms of the tender or the tender, as revised, and modified, are not accepted or if the terms of the offer and the acceptance are not the same, the acceptance remains a mere counter offer and there is no concluded contract. It should, therefore, be ensured that the terms incorporated in the acceptance are not at variance with the offer or the tender and that none of the terms of the tender are left out. In case, uncertain terms are used by the tenderers, clarifications should be obtained before such tenders are considered for acceptance. If it is considered that a counter offer should be made, such counter offer should be carefully drafted, as a contract is to take effect on acceptance thereof.

If the subject matter of the contract is impossible of fulfillment or is in itself in violation of law such contract is void.

3.10 Withdrawal of an Offer or Proposal

A tenderer firm, who is the proposer may withdraw its offer at any time before its acceptance, even though the firm might have offered to keep the offer open for a specified period. It is equally open to the tenderer to revise or modify his offer before its acceptance. Such withdrawal, revision or modification must reach the accepting authority before the *date and time of opening of tender*.

No legal obligations arise out of such withdrawal or revision or modification of the offer as a simple offer is without a consideration. Where, however, a tenderer agrees to keep his offer open for a specified period for a consideration, such offers cannot be withdrawn before the expiry of the specified date. This would be so where earnest money is deposited by the tenderer in consideration of his being supplied the subsidiary contract and withdrawal of offer by the tenderer before the specified period would entitle the purchaser to forfeit the earnest money.

3.11 Withdrawal of Acceptance

An acceptance can be withdrawn before such acceptance comes to the knowledge of the tenderer. A telegraphic revocation of acceptance, which reaches the tenderer before the letter of acceptance, will be a valid revocation.

3.12 Changes in terms of a concluded Contract

No variation in the terms of a concluded contract can be made without the consent of the parties. While granting extensions or making any other variation, the consent of the contractor must be taken. While extensions are to be granted on an application of the contractor, the letter and spirit of the application should be kept in view in fixing a time for delivery.

3.13 Discharge of Contracts

A contract is discharged or the parties are normally freed from the obligation of a contract by due performance of the terms of the contract. A contract may also be discharged: -

(a) **By mutual agreement:** If neither party has performed the contract, no consideration is required for the release. If a party has performed a part of the contract and has undergone expenses in arranging to fulfill the contract it is necessary for the parties to agree to a reasonable value of the work done as consideration for the value.

(b) **By breach:** In case a party to a contract breaks some stipulation in the contract which goes to the root of transaction, or destroys the foundation of the contract or prevents substantial performance of the contract, it discharges the innocent party to proceed further with the performance and entitles him to a right of action for damages and to enforce the remedies for such breach as provided in the contract itself. A breach of contract may, however, be waived.

(c) **By refusal of a party to perform:** On a promisor's refusal to perform the contract or repudiation thereof even before the arrival of the time for performance, the promisee may at his option treat the repudiation as an immediate breach putting an end to the contract for the future. In such a case the promisee has a right of immediate action for damages.

(d) **In a contract where there are reciprocal promises:** If one party to the contract prevents the other party from performing the contract, the contract may be put to an end at the instance of the party so prevented and the contract is thereby discharged.

3.14 Stamping of Contracts

Under the sales of goods act, an agreement or memorandum of agreement for or relating to the sale of goods or merchandise exclusively is exempt from payment of stamp duty. (A NOTE OR MEMORANDUM sent by a Broker or Agent to his principal intimating the purchase or sale on account of such principal is not so exempt from stamp duty.) The Stamp Act provides that no Stamp Duty shall be chargeable in respect of any instrument executed by or on behalf of or in favour of the Government in cases where but for such exemption Government would be liable to pay the duty chargeable in respect of such instrument.

3.15 Contract Effective Date

The date of commencement of the obligations under the contract on the parties to a contract is referred as the contract effective date. This date should be invariably indicated in each contract, as per agreed terms and conditions. The Ministries/Departments are advised to set the effective date to be a date after the following:

(i) Date of signing of the contract.

(ii) Furnishing of performance bond in terms of performance security.

(iii) Receipt of Bank Guarantee for advance payment.

(iv) Obtaining Export Licence for supply of stores by seller and confirmation by the buyer.

(v) Receipt of End User's Certificate. The supplier shall provide the End User's Certificate within 30 days of the signing of the contract.

3.16 GENERAL PRINCIPLES FOR CONTRACT

The following general principles should be observed while entering into contracts:

(1) The terms of contract must be precise, definite and without any ambiguities. The terms should not involve an uncertain or indefinite liability, except in the case of a cost plus contract or where there is a price variation clause in the contract.

(2) Standard forms of contracts should be adopted wherever possible, with such modifications as are considered necessary in respect of individual contracts. The modifications should be carried out only after obtaining financial and legal advice.

(3) In cases where standard forms of contracts are not used, legal and financial advice should be taken in drafting the clauses in the contract.

(4) (a) A Ministry or Department may, at its discretion, make purchases of value up to thousands of naira by issuing purchase orders containing basic terms and conditions.

(b) In respect of Works Contracts, or Contracts for purchases valued between millions and billions of naira, where General Conditions of Contract (GCC), Special Conditions of Contract (SCC) and scope of work, the letter of acceptance will result in a binding contract.

(c) In respect of contracts for works with estimated value of millions of naira or above or for purchase above billions of naira, a Contract document should be executed, with all necessary clauses to make it a self-contained contract. If however, these are preceded by Invitation to Tender, accompanied by GCC and SCC, with full details of scope and specifications, a simple one page contract can be entered into by attaching copies of the GCC and SCC, and details of scope and specifications, Offer of the Tenderer and Letter of Acceptance.

(d) Contract document should be invariably executed in cases of turnkey works or agreements for maintenance of equipment, provision of services etc.

(5) No work of any kind should be commenced without proper execution of an agreement as given in the foregoing provisions.

(6) Contract document, where necessary, should be executed within 21 days of the issue of letter of acceptance. Non-fulfilment of this condition of executing a contract by the Contractor or Supplier would constitute sufficient ground for annulment of the award and forfeiture of Earnest Money Deposit (EMD).
(7) Cost plus contracts should ordinarily be avoided. Where such contracts become unavoidable, full justification should be recorded before entering into the contract. Where supplies or special work covered by such cost plus contracts have to continue over a long duration, efforts should be made to convert future contracts on a firm price basis after allowing a reasonable period to the suppliers / contractors to stabilize their production /execution methods and processes.

Explanation: A cost plus contract means a contract in which the price payable for supplies or services under the contract is determined on the basis of actual cost of production of the supplies or services concerned plus profit either at a fixed rate per unit or at a fixed percentage on the actual cost of production.

(8) (a) Price Variation Clause can be provided only in long-term contracts, where the delivery period extends beyond 18 months. In short-term contracts firm and fixed prices should be provided for. Where a price variation clause is provided, the price agreed upon should specify the base level viz, the month and year to which the price is linked, to enable variations being calculated with reference to the price levels prevailing in that month and year.

(b) A formular for calculation of the price variations that have taken place between the Base level and the Scheduled Delivery Date should be included in this clause. The variations are calculated by using indices published by Governments or Chambers of Commerce periodically.

(c) The Price variation clause should also specify cut off dates for material and labour, as these inputs taper off well before the scheduled Delivery Dates.

(d) The price variation clause should provide for a ceiling on price variations, particularly where escalations are involved. It could be a percentage per annum or an overall ceiling or both. The buyer should ensure a provision in the contract for benefit of any reduction in the price in terms of the price variation clause being passed on to him.

(e) The clause should also stipulate a minimum percentage of variation of the contract price above which price variations will be admissible (e.g. where resultant increase is lower than two per cent. no price adjustment will be made in favour of the supplier).

(f) Where advance or stage payments are made there should be a further stipulation that no price variations will be admissible on such portions of the price, after the dates of such payment.

(g) Where deliveries are accepted beyond the scheduled Delivery Date subject to levy of liquidated damages as provided in the Contract, the liquidated damages (if a percentage of the price) will be applicable on the price as varied by the operation of the Price variation clause.

(h) No price variation will be admissible beyond the original Scheduled Delivery Date for defaults on the part of the supplier.

(i) Price variation may be allowed beyond the original Scheduled Delivery Date, by specific alteration of that date through an amendment to the contract in cases of Force Majeure or defaults by Government.

(j) Where contracts are for supply of equipment, goods etc, imported (subject to customs duty and foreign exchange fluctuations) and / or locally manufactured (subject to excise duty and other duties and taxes), the percentage and element of duties and taxes included in the price should be specifically stated, along with the selling rate of foreign exchange element taken into account in the calculation of the price of the imported item. The mode of calculation of variations in duties and taxes and Foreign exchange rates and the documents to be produced in support of claims for such variations should also be stipulated in the Contract.

(k) The clause should also contain the mode and terms of payment of the price variation admissible.

(9) Contracts should include provision for payment of all applicable taxes by the contractor or supplier.

(10) “Lumpsum’ contracts should not be entered into except in cases of absolute necessity. Where lumpsum contracts become unavoidable, full justification should be recorded. The contracting authority should ensure that conditions in the lumpsum contract adequately safeguard and protect the interests of the Government.

(11) Departmental issue of materials should be avoided as far as possible. Where it is decided to supply materials departmentally, a schedule of quantities with the issue rates of such material as are required to execute the contract work should form an essential part of the contract.

(12) (a) In contracts where government property is entrusted to a contractor either for use on payment of hire charges or for doing further work on such property, specific provision for safeguarding

government property (including insurance cover) and for recovery of hire charges regularly, should be included in the contracts.

(b) Provision should be made in the contract for periodical physical verification of the number and the physical condition of the items at the contractor's premises. Results of such verification should be recorded and appropriate penal action taken where necessary.

(13) Copies of all contracts and agreements for purchases of the value of Millions of naira and above, and of all rate and running contracts entered into by civil departments of the Government other than the departments like the Directorate General of Supplies and Disposals for which a special audit procedure exists, should be sent to the Audit Officer and /or the Accounts officer as the case may be.

(14) (a) The terms of a contract, including the scope and specification once entered into, should not be materially varied.

(b) Wherever material variation in any of the terms or conditions in a contract becomes unavoidable, the financial and other effects involved should be examined and recorded and specific approval of the authority competent to approve the revised financial and other commitments obtained, before varying the conditions.

(c) All such changes should be in the form of an amendment to the contract duly signed by all parties to the contract.

(15) Normally no extensions of the scheduled delivery or completion dates should be granted except where events constituting force majeure, as provided in the contract, have occurred or the terms and conditions include such a provision for other reasons. Extensions as provided in the contract may be allowed through formal amendments to the contract duly signed by parties to the contract.

(16) All contracts shall contain a provision for recovery of liquidated damages for defaults on the part of the contractor.

(17) A warranty clause should be incorporated in every contract, requiring the supplier to, without charge, repair or rectify defective goods or to replace such goods with similar goods free from defect. Any goods repaired or replaced by the supplier shall be delivered at the buyers premises without costs to the buyer.

(18) All contracts for supply of goods should reserve the right of Government to reject goods which do not conform to the specifications.

4.0 CONCLUSION

There is a growing realisation of the specialised nature of the purchasing function. No longer is purchasing like the buying of the olden days. Purchasing has developed into a science and has its own rules, conventions and practices and uses all the processes of management that make it contribute effectively to the company's profits the question of organisational importance. The first assumption is that purchasing is a specialized activity. If this is accepted, then it follows that all purchasing activities in the company should be concentrated in this specialist department.

5.0 SUMMARY

In this unit, we have discussed issues related to the general principles of entering into contracts with specific focus on the elementary Legal Practices and the general principles for contract.

he elements and principles of contract law and the meaning and import of various legal terms used in connection with the contracts are available in the Company and Allied Matters decree of 1990 in Nigeria read with the Sale of Goods Act, 1930.

Companies are association of individuals registered under Companies Act in which the liability of the members comprising the association is limited to the extent of the shares held by them in such companies. The company, after its incorporation or registration, is an artificial legal person which has an existence quite distinct and separate from the members of shareholders comprising the same. A company is not empowered to enter into a contract for purposes not covered by its memorandum of association; any such agreement in excess of power entered into the company is void and cannot be enforced.

6.0 TUTOR MARKED ASSIGNMENTS

Outline and explain the general principles your company has put in place to be observed while entering into contracts

7.0 REFERENCES

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UNIT 4: SUPPLIER'S SELECTION ACTIVITIES............................36

Contents

1.0 INTRODUCTION

Suppliers are major resources for manufacturers and traders alike. It would not be possible operate to without them. An adequate supplier base is essential to the economic wellbeing of a firm. Perhaps, it would be reasonable to argue that the most important purchasing decisions are concerned with selecting the right source of supplier; that is, if the correct source decision is made in a particular instance, then the buying company would receive the right goods in the right condition, in the right quality, at the right time and at the right price. Selection and management of the right supplier is the key to obtaining the desired level of quality, on time and at the right price to meet up with the company's purchasing objectives and policies. The management of the supply market however requires advance planning, forethought and the quality to make some decisions. Sourcing in purchasing has gone beyond simply picking a supplier for each order in isolation.

1) It involves continuing relationships, both with preferred source which are actually supplying goods and services, and with potential source which may have been passed over for the present but are still in the running.
2) It involves decisions about how to allocate the available business, and what terms to do business on.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

• State and discuss factors in Supplier selection

• Highlight and comment on the sources of supplier's information

• State and describe and/or calculate both qualitative and quantitative processes of supplier Evaluation (i.e. Pre- and Post - selection evaluation)

3.0 MAIN CONTENT

3.1 Issues Involved in Sourcing Function

D. Dobler and D.N. Burt (1996) argued that buyers must take six important supplier-oriented actions in order to satisfy the performance of sourcing function in purchasing. It is argued that the buyers must:

1) Develop and maintain a viable supplier base or source

2) Address the appropriate strategic and tactical issues

3) Ensure that potential suppliers are carefully evaluated and they have the potential to be satisfactory partners.

4) Decide whether to use competitive bidding or negotiation as the basis of source selection

5) Select the appropriate source

6) Manage the selected supplier to ensure timely delivery of the required quality at the right price.

Peter Baily et al (1996) further argued that for its proper performance, sourcing requires supply market research. This is a normal part of buying work, undertaken informally by buyers when they talk to representatives or salesmen, visit exhibitions, read trade journals, and investigates the market before placing orders. It may additionally be undertaken as staff or support function to buyers by full-time purchasing research staff within a purchasing services section of company. The objectives for this supply market research include:

1) The identification of the set of actual and potential sources, which constitute a supply.

2) Investigation of the suppliers' capabilities,

3) Examination of market trend and prospects of long-term supply; and

4) The general keeping of the buyer's ears to the ground.

Figure 4-1 outlines the procedure normally involved in selecting suppliers. The model suggests that:

1) the buyer, once receipt of a purchase requisition, first checks whether the organization is currently committed to the particular supplier for the supply of such items and, if not;

2) whether an existing source might satisfy the requirement

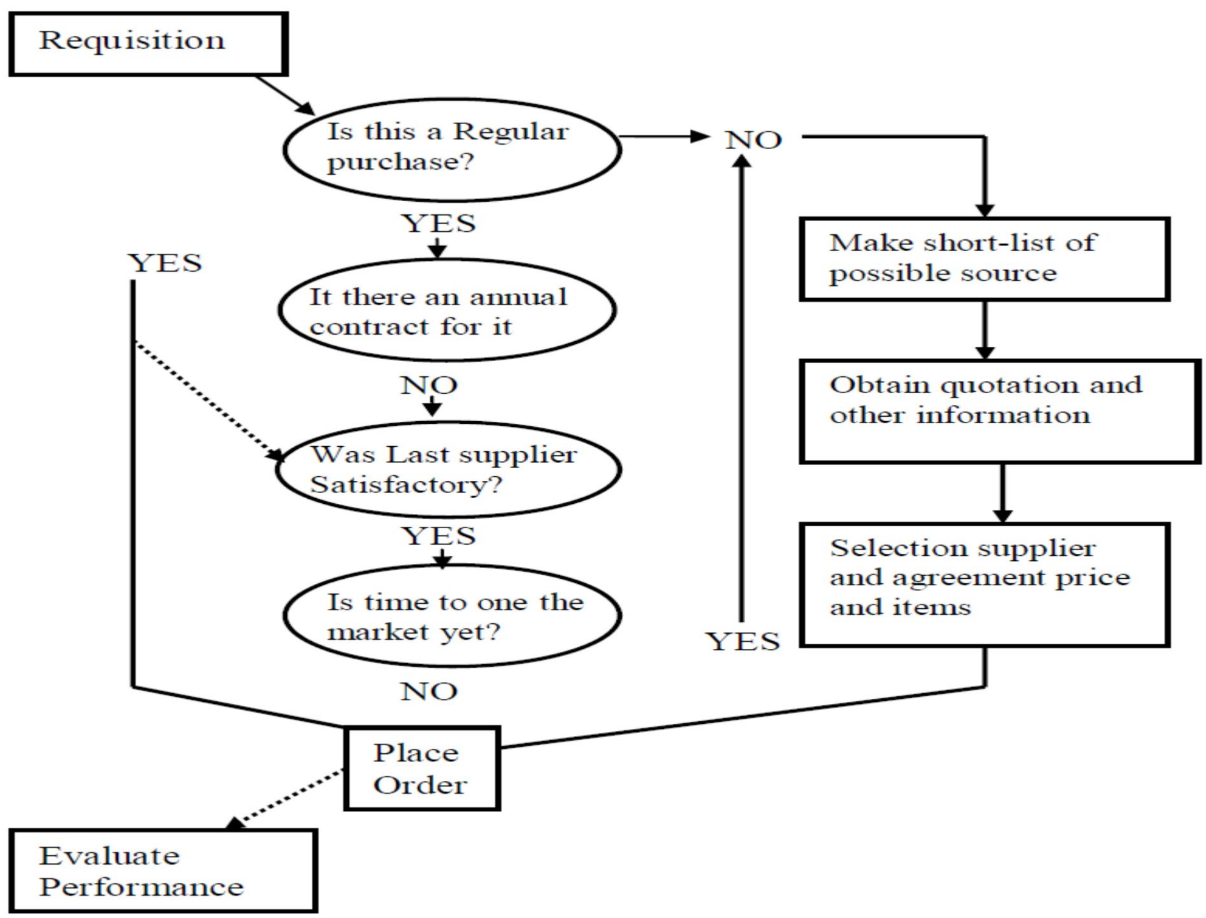

Figure 4.1: Outline of procedures for selecting suppliers. The broken line indicates steps taken after orders have been placed.

3) Repeat ordering with an existing source would be normal unless for some reasons necessitating a review of such an arrangement. Such reasons might include:

a) recent price increases,

b) recent extensions in supplier supply lead-time

c) failing to meet specifications,

d) decline in vendor rate performance.

3.2 Factors in Supplier's Selection

The primary concern of the purchasing department is to successfully identify and secure the services of those suppliers that will help realise both objectives of the purchasing department and the overall company's objectives. Hence when selecting a supplier, the buyer is attempting to find a company or companies which will meet its needs. Those needs usually include reliability in quality and service terms, while the relevant pricing is competitive. The benefit of accurate supplier selection can therefore include such factors as reliability, quality, delivery, performance, reputation and continuity of supplies. Great care must be taken over the selection of every supplier: short cuts in this area will lead to inefficiency and loss of profitability in the long run. The supplier's selection decision is based on the following factors, all of which must be carefully researched and analysed by the purchasing department.

1) Assurance of Supply

Reliability of supply is becoming increasingly important to both buyers and suppliers. Hence, supplier's who suffer recurring shortages themselves must be used with great care, regardless of their other desirable capabilities. Suppliers who have assured, long-term source for their raw materials and component parts should be favoured and developed.

2) Size of Supplier

Some purchasing authorities theorize that the size of an order should correlate with the size of supplier – receiving the order.

3) The Number of Suppliers

The number of suppliers to be selected for a particular line of products or group of items is another important factor that must be given careful consideration. Selecting one supplier for a particular product, no matter how reliable the source could be proves unwise in the long run. Similarly, selecting too many suppliers for an individual material may result in the buyer's inability to fully tap the resources of these suppliers.

4) Developing New Source of Supply

In some cases a buyer is not able to select but must create a satisfactory supplier. If existing suppliers cannot satisfy a company's needs, a logical alternative is to create a supplier that can. Encouragement of this nature may involve setting-up or equipping such local producer financially and materially up to the level expected by the buyer.

5) Conflict of Interest

In selecting suppliers, buyers must be aware of conflicts of interest. A conflict of interest exists when buyers must divide their loyalty between the firm, which employs them, and another firm.

6) The Policy of the Buying Firm

A company's policy may for example favour reciprocity, single or multiple sourcing. In purchasing, suppliers who patronize the buying company are given priority when it comes to selection of suppliers. Some companies makes it a matter of policy to reward indirectly, those customers that buy from them regularly and are found capable of performing certain jobs for the company.

7) Ethical Consideration

Buyers should keep themselves as free as is humanly possible from unethical influences in their choices of suppliers. Gift from suppliers which are intended to influence buying decisions have no place in a professional purchasing department. In most cases, commercial bribery is a criminal offense.

8) Dishonest Suppliers.

Dishonest sellers exist in the industrial world just as they do in the consumer world. Purchasing personnel should be wary of dishonest suppliers and endeavour to avoid them. Their aim is to swindle the buying company.

9) Local Sources It is always desirable to patronize suppliers located within the buyers' immediate environment. This will help to promote good relationship between the local community and the company. It is only when materials in question are not available at the expected quantum that buying from distant source can be justified.

10) Government Policy

For the purpose of controlling foreign exchanges, government may for example, impose restrictions on importations of certain goods thereby preventing the sourcing of the goods in foreign supply markets. In such cases, the buyer's range of sourcing is limited to the local market.

11) Others Other factors, which for obvious reasons may be taken into account in supplier's selection, can be listed as follows:

1) Relative price of goods and services supplied by the supplier, compared with his competitors.

2) Delivery dates, methods and cost delivery. In many instances, the delivery element is more important than price, provided the prices are within the boundaries of the main competitors.

3) Supplier's reputation, especially within the industry or trade.

4) History of labour relations at the supplier's end.

5) Financial solvency of the suppliers;

6) Legal constraint, e.g. patent law.

3.2.1 Attributes of a Good Supplier

Peter Baily et al (1996), suggested a number of attributes which might be regarded as desirable for a typical relationship. These include:

1) Delivery on time

2) Provide consistent quality

3) Gives a good price

4) Has a stable background

5) Provides a good service backup

6) Provides a good stock service

7) Does what he/she says they will do

8) Provides technical advice

9) Keeps the buyer informed on progress

3.3 Sources of Supplier Information

The task of obtaining information about sources of supply is a continuous exercise in purchasing function. Sources of information about suppliers are plentiful. The following sources should prove helpful to a buyer in preparing a list of potential suppliers.

1) Supplier Purchasing Information File

File on past and existing suppliers are already source of information where the purchasing department can always contact to obtain whatever information they may require about suppliers. Such supplier information files commonly contain the name of each supplier, a list of materials he can supply, his delivery history, his quality rejection record, his overall desirability as a supplier, and general information concerning his plant and management.

2) Supplier Catalogues

Catalogues are a commonly used source of supplier information. Many purchasing departments maintain a catalogue room, where users can examine the catalogues to try locate the materials they need. Some large companies keep a special library file containing catalogues, price lists and other literature from potential suppliers.

3) Trade Journal

Trade journals are another excellent source for obtaining information about possible suppliers. Advertisements in trade journals are often a buyer's first contact with vendors and their products. In the field of purchasing, the magazines, purchasing and purchasing world are perhaps best known and widely read trade journals.

4) The "Yellow Pages"

Another commonly known directory is the classified 'yellow page' section of telephone directories. Though, this source of information is frequently of limited value to many industrials buyers, yellow pages do, however, have the virtue of being well indexed. Also they can serve as a useful starting point if other sources have proved fruitless, and local sources are desired.

5) The Internet

Understanding the versatility of information technology through the nerves of computing is perhaps a prerequisite for appreciating the enormity of advantages of using the internet for business and other purposes. From the inception of the internet evolution (which originated as APPANET, a United States Government Research Project), the net has grown to become an information super highway, linking many millions of computer systems and digital machines as well as millions of users around the world. A great majority of these linkages and users are primarily hooked-up for economic (business) purposes.

The internet has become an electronic market place such that a tremendous amount of activities (e.g. retail activities, selling digital delivery of services, buying or procurement, etc) takes place as companies now set-up their customer-service functions on the internet.

The beauty of the internet is that it can make it easier for companies in developing countries to do business globally. Companies can now set-up internet facilities and immediately have access to a billion of people and other business globally as a market. This opens up a wave of information opportunities to buyers world-wide to expand their knowledge of new products, new vendors, and new ideas.

6) Sales Personnel

Sales personnel is an excellent source of information for possible sources of supply. Not only are they usually well informed about the capabilities and features of their owner products. But they are also familiar with similar and competitive products as well. By the very nature of their specialized knowledge, sales people can often suggest new applications for their products, which will eliminate the search for new suppliers.

7) Trade Exhibit

Regional and national trade shows are still another way in which buyers learn about possible source of supply. The use of exhibition as a means of sales presentation is greatly increasing. They provide an excellent opportunity for buyers to see various new products and modifications of old products. They also offer buyers an opportunity to compare similar products from different manufacturers.

8) Company Personnel

Personnel in other departments within a company are often knowledgeable about the source of materials relating to their specialisation. Through their association in professional organisations, civic associations or social groups, these employees often learn about outstanding suppliers.

9) Other Purchasing Departments Purchasing departments in other companies are most helpful sources of information concerning supplier with whom they deal.

10) Organisations Promoting Trade Information on suppliers can readily be obtained from trade register and directories compiled by the umbrella bodies of trade associations such as the manufacturers Association of Nigeria (MAN), Chambers of commerce, etc.

Such directories contain names of manufacturers, their addresses and branches as well as their various products. Similarly, embassies and commercial attaches are usually keen to help buyers to find sources of supply in the territories they represent.

3.4 Supplier Evaluation

In purchasing, suppliers are regarded as partners in progress to the buyer's organisation. This is because supplier's performance is capable of influencing the organisation's success. For this reason, selection of suppliers as well as evaluation of their performance is an important responsibility of not only the purchasing department, but the entire buying company. After a major supplier has been selected and they-supplier relationship has begun to develop, it is important monitor and assess the supplier's overall performance. The purpose is to enhance the relationship and thereby control performance. The evaluation of actual and potential source is a continuing process in purchasing departments. Actual source with which one is dealing regularly can be evaluated largely on their track record: on the actual experience of working with them. This is known as vendor rating. Vendor rating is intended to evaluate the performance of supplier in terms of prices, quality, delivery and service. The type of evaluation required to determine suppliers' capability however varies with:

1) the nature,

2) complexity; and

3) the total value for the purchase to be made.

3.4.1 Pre-Selection Evaluation

This type of evaluation is aimed at obtaining information about the prospective supplier to determine his suitability to meet the buyer's requirement if selected. Potential sources can be evaluated only by judgment of their capabilities. Pre-selection evaluation may generally involve the following considerations:

1) Supplier's Registration Form

As a pre-requisite, most suppliers seeking to do business with another organisation are expected to pass through a formality by completing a registration form made available by the buying company.

The type of information usually required from such suppliers are details like name of company, address, type of business or products, financial capabilities, and a host of other information that will enable the buying company determine the suitability or otherwise of the potential source.

2) Product Testing

In some cases, special request is made for the samples of the product advertised or intended to be supplied for preliminary testing. If these products are used for certain period by the company and are found suitable for the purpose for which they are needed, the supplier can be considered.

3) Plant Visits

On-the-spot surveys of facilities and personnel by the technical and commercial representatives of the purchaser are often carried out to evaluate potential suppliers-although sometimes it may possible to eliminate this on the basis of a supplier's reputation, as obtained from word – of – mouth and published information.

4) Financial Condition

This is an important factor in evaluating capability of a potential supplier. This type of evaluation places more emphasis on the solvency of the supplier over and above other requirements. Financially strong firms are usually, although not always, managerially strong also, hence they generally make good suppliers. Analysis of balance sheets and profit and loss statements can be of immense benefit in the evaluation of vendor's financial condition.

5) Management

It becomes necessary at times to have insight of the potential supplier's management quality of his organisation, in terms of personnel, plant maintenance, staff wages and welfare package. This is because, if an organisation is well managed, cases like high labour turnover rate, industrial unrest which are capable of affecting supplier's product quality, delivery performance and service will be completely eliminated or reduced to the barest minimum.

3.4.2 Post-Selection Evaluation of Supplier

When suppliers are finally selected and have been allowed to perform over a period, it is necessary that their performances are evaluated for the purpose of determining their respective capability in terms of quality, price, delivery and service.

Donald W. Dobler and David N. Burt (1996) reviewed three types of evaluation plans that were investigated by the National Association of Purchasing Management. These include:

1) Categorical Plan

Under this plan, personnel from various departments of the buying company maintain informal evaluation records. The individuals involved traditionally include personnel from purchasing, engineering, quality, accounting, and receiving. For each major supplier, each evaluator prepares a list of performance factors, which each supplier is evaluated against. After the factors are weighted for relative importance, each supplier is then assigned an overall group evaluation, usually expressed in simple categorical terms, such as "preferred", "adequate", "unsatisfactory". This simple qualitative plan is easy to administer and has been reported by many firms to be very effective. The categorisation sample of overall scores is shown in Table 4.1

	Performance Factor	Preferred	Adequate	Unsatisfactory
1	Quality	18-20	10-17	0-9
2	Delivery	16-20	8-15	0-7
3	Commercial	18-20	12-6	0-11
4	Technology	18-20	10-16	0-8
5	Management	16-20	10-14	0-8
	Target total	86-100	50-85	0.49

Table 4.1 Supplier performance and ranking system categorisation of overall scores

To achieve Preferred Supplier status, scores in all categories must fall within the ‘Satisfactory’ and Adequate’ ranges. Any ‘Unsatisfactory’ scores will be followed up and reviewed and, if not improved within acceptable timescales, may lead to deselection.
A guide to classification based on scores is given with target scores for preferred suppliers with whom the company intends to place long-term business identified.

2) The Weighted Point Plan

This plan involves giving weight to every performance factor to be evaluated and oftentimes, various aspects of quality, service, delivery and price are given weights.
For example in one circumstance, quality might be weighted 30 percent, service 25, and price 40 percent. In another, quality could be raised to 45 percent, and price reduced to 20 percent.
The weight selected in any specific situation represents the buyer’s judgments about the relative importance of each factor.

After performance factors have been selected and weighted, a specific procedure performance on each factor must be expressed in qualitative terms. To determine a supplier’s overall rating, each factor weight is multiplied by the supplier’s corresponding performance number; the results (for each factor) are then totalled to get the supplier’s final rating for the time period in question.

ILLUSTRATION 1 The following hypothetical case illustrates the procedure. Assume that the purchasing department of Koriope & Sons Ltd. has decided to weight and measure the three basic performance factors as follows:

Weight	Factors	Measurement formula
45%	Quality performance=	100%-percentage of rejects
25%	Service performance=	100%- 5% for each failure
20%	Price performance =	Lowest Price offered
		Price actually paid

Assume further that suppliers anytime performed as follows during the past month: Seven percent of his items were rejected for quality reason; Four unsatisfactory split shipments were received; and vendor Ayim's price was 110 per unit. Compare with lowest offer of N80 per unit. The workings below summarize the total performance evaluation for supplier Ayim

Factor	Weight	Actual Performance
Quality	45	7% rejects
Service	25	4 failures
Price	20	₦ 100

Performance Evaluation

For quality $= 45 \times (100\% - 7\%)$

$45 \times (1.00\text{-}0.007) = 41.90$

For service $= 25 \times (100\% - (5\% \times 4)$

$= 25 \times (1.00 - .05 \times 4)$

$= 25 \text{x} 0.8 = 20$

For price $= 20 \times \frac{N80}{N100}$

$= 2\text{x } 0.8 = 16$

Overall Evaluation: 41.90 +16 = 77.9%

This example is not the only method available, nor has it been so comprehensively dealt with. Some of the more sophisticated applications can be very complicated. The above can however be used to evaluate any number of different suppliers whose performance is particularly important during a given operating period. Example 2 further illustrates this point.

ILLUSTRATION 2 Arijenimondaru Co. Ltd. divides the purchase of Abacha television sets between Kalu and Naaba. He wishes to compare their performance with regard to quality and delivery for two years, 2003 and 2004. The year 2003 is taken as the base year.

SOLUTION

• Quality rating

Year	Vendor	Intake	Rejects	%Reject	Index
2005	Kalu	2,900	75	2.6	100
2005	Naaba	1,850	45	2.4	100
2006	Kalu	3,400	83	2.4	92
2006	Naaba	2,350	47	2.0	83

Index = For Kalu :- $(2006) = \frac{2.4}{2.6} \times 100 = 92$

For Naaba :- $(2006) = \frac{2.0}{2.4} \times 100 = 83$

Remarks: In 2006 Kalu recorded an 8% defective materials supplied rate (i.e. percentage rejects) while Naaba recorded suffered a 17% reject rate of total materials supplied in the given year.

• **Delivery rating**

In a similar way to what was done in respect of quality performance, it is possible to keep delivery records, showing shortage, early or late arrivals, or any variation on the contracted delivery programme. These facts can be used to produce a delivery rating, which may be applied either separately or in conjunction with quality rating. This makes the whole operation more complicated, and is normally attempted only where delivery is of vital importance and where the quality scheme is already well established.

Year	Index	Vendor	Delivery		Total Day Late	Average Day Late
2005	100	Kalu	7	49	7	
2005	100	Naaba	15	75	5	
2006	85.7	Kalu	10	60	6	
2006		Naaba	8	24	3	60

Index: for Kalu:- $(2006) = \frac{6}{7} \times 100 = 85.7$

For Naaba: - $(2006) = \frac{3}{5} \times 100 = 60$

Remark: In 2006 the performance of Kalu showed a 14.3% delivery failure as against Naaba's 40% delivery failure rate in the give year. Overall rating: Assuming that quality and delivery are weighted 45% and 15% respectively; the overall rating would be:

Factory	Supplier Kalu	Naaba
Delivery	85.7	60
Quality	92	83

$$\text{Overall index for Kalu} = \frac{92\ (45) + 85.7\ (15)}{100}$$

$$= \frac{4140 + 1285.5}{100}$$

$$= \frac{5425.5}{100} = 54.3\%$$

$$\text{Overall index for Naaba} = \frac{83\ (45) + 60\ (15)}{100}$$

$$= \frac{3735 + 900}{100}$$

$$= \frac{4635}{100} = 46.4\%$$

Remarks: Vendor Kalu demonstrated superior performance rating in the year in question.

► The Cost – Ration Plan

This involves the use of management tools or techniques such as standard cost, average cost, weighted average cost, etc. to determine or evaluate the performance of each supplier. This type of evaluation is based mainly on the price and cost of rejects or non-performance by the supplier. All the three of the evaluation plans discussed – categorical, weighted-point, and cost-ration – involve varying degree of subjectivity and guesswork.

The Quantitative (weight-point and cost-ration) remarkably are deficient in the light of: 1) Wrong impression it gives about its scientific accuracy while in effect, they are not more accurate than the assumptions on which the quantitative data are based. 2) The high cost of collecting the data on which the rating are based; 3) Supplier performance is often affected by circumstance outside the control of the vendor. In the final analysis, therefore, supplier evaluation must represent combined appraisal of facts, quantitative computations, and value judgments. It simply cannot be achieved effectively by mechanical formula alone.

SELF ASSESSMENT EXERCISE

What objectives should supply market research seek to achieve?

4.0 CONCLUSION

An important function of purchasing is the identification of suitable sources of supply. The systematic investigation and comparison of sources, the evaluation and monitoring of performance of supply sources and the development of appropriate procedures with supplier are therefore of importance. In purchasing, suppliers are regarded as partners-in-progress to the buyer's organisation. This is because supplier's performance is capable of influencing the organisation's success. For this reason, selection of supplier as well as evaluating their performance is an important responsibility of not only the purchasing department, but the entire buying company.

5.0 SUMMARY

Selection and management of the right supplier is the key to obtaining the desired level of quality, on the time and at the right price to meet up with the company's purchasing objectives and policies.

The management of the supply may however require advance planning, forethought and the ability to make some decisions. Sourcing in purchasing has not only gone beyond simply picking a supplier for each order in isolation but also as follows:

• It involves continuing relationships, both with preferred source which are actually supplying goods and services, and with potential source which may have been passed over for the present but are still in the running.

• It involves decisions about how to allocate the available business, and what terms to do business on.

6.0 TUTOR-MARKED ASSIGNMENT

What are the Important Supplier – oriented actions that buyers must take in order to satisfy the performance of sourcing function in purchasing?

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Contents

1.0 INTRODUCTION

Price is important both to the seller and the buyer. It is regarded as one of the elements in the marketing mix. As it is used in purchasing, price is the mechanism for measuring the value of good and services in monetary terms. 1) This definition is consistent with one of the main objectives of purchasing which is to obtain value for money on all occasions. 2) The definition also enables us to appreciate the role of price in the purchasing and supply functions. For the purchaser however, price is just one of the elements taken into account in making a purchasing decision. Non-price factors, which may be important, include; delivery, service, reliability, product quality, terms of payment, location and many more. Value for money therefore depends not only on price, but on what is provided for the price.

2.0 OBJECTIVES

At the end of studying this unit, you should be able to:

• list and explain the importance of obtaining materials at the right price

• state clearly the role of price in purchasing

• describe how buyers obtain prices

• highlight and discuss the factors influencing price setting

• enumerate the uses and importance of discount in the purchasing function

• discuss the issues involved in procurement timing policies

3.0 MAIN CONTENT

3.1 Importance of Obtaining Materials at the Right Price

Obtaining materials at the right price is important; it literally can mean the difference between a firm's success or failure. With the traditional approach to purchasing, it is easy for the importance of pricing to be over-looked. For instance, in traditional purchasing theory: (1) It is frequently stated that price may be low or high, what matters most is service and delivery reliability. Or rather, (2) Price is not the major consideration in making purchases; rather, the main concern is the continuous flow of materials at all cost. This traditional attitude is loaded with massive implications, the most obvious of which are: 1) The danger of collusion to buy goods and services at high or inflated price; 2) The danger of buyer developing inertia or unwillingness to investigate new and cheaper sources of supply; 3) The possibility that the cost-saving function of purchasing may be totally ignored or abdicated. These implications are all together very detrimental to the corporate financial position.

Purchasing should ideally aim for the right price; this is a price, which gives the best value to the organisation, taking quality, delivery and relative urgency into account. This may not always be the lowest price available, but the one, which represents the best value over a period of time. Professional buyers commonly interpret the right price as one that is fair and reasonable to both the buyer and seller.

3.2 The Role of Price in Purchasing

As a monetary phenomenon, Fajemilua (1997: p.78) listed the following five roles price plays in the purchasing cycle:

1) It is the basic unit for measuring and assessing other factors (such as quantity and so on) which influence the purchasing decision process;

2) It provides the yardstick for comparing supplier's quotations and assessing the relative value of their service;

3) It is the basis for costing store issues; evaluating stock balances damages for losses in a storehouses

4) Price is used for costing, purchasing and supply operations with a view to evaluating performance.

5) It provides the yardstick for the application of most stock-control techniques.

3.3 How Buyers Obtain Price

The methods of communicating price will vary according to: 1) The nature and complexity of the purchase; and 2) The manner in which it is being dealt with, that is, either by an individual consumer or an industrial buyer. Two broad categories of methods are however discussed in this text. And these are:

3.3.1 General Methods: Some of the general methods used in price determinations are as follows:

1) **Haggling:** This is the traditional method and it is used mainly in making purchases for private consumptions. The method calls for bargaining and usually, the selling price is between the range of prices, which will satisfy both the seller and the buyer.

2) **Auctioning:** Here, an auctioneer puts an article on sale and calls for bids. The prospective buyers then make their offers. In the end, the article goes to the highest bidder. The selling price of the article will therefore depend on the keenness of the buyers to buy.

3) **Fixed Pricing:** Many sellers may not want their customers to haggles on price. Rather, they prefer to fix prices at which they think they can sell their goods. This is the method used for the purchase of goods in most supermarkets and retail stores. However, the seller cannot fix price and at the same time determine the quantity to be sold.

4) **Demand and Supply Approach:** According to the micro-economic theory, the buyer on the one hand will always buy more at a lower price than at a higher price and suppliers on the other hand will always supply more at a higher price than at a lower price given that all things are equal. The equilibrium price of a commodity will be fixed at the point where the forces of demand equate the forces of supply.

3.3.2 The Industrial Buyer's Approach

The professional buyers determine the purchase price of goods and services using a number of methods. The more common methods include:

1) The Use of Published Price Lists: Price of many industrial goods and services are frequently published in newspapers, price catalogues and trade journals.

An experienced buyer does his best to keep abreast of published price lists or gazette price and makes use of such price information in the procurement of goods and services for his organization.

2) Contact with Salesmen: The professional buyer is placed in a unique position to meet and interact with salesmen from different supplying firms and organisations. Through this discussion with such salesmen, the buyer becomes conversant with current prices of industrial goods and services.

3) Quotations: The commonest method used to determine purchasing prices is by inviting quotations from the prospective suppliers. The quotation obtained are compared and analysed to determine the most advantageous offer.

4) Tendering: This can be an open selection depending on the type of purchase or policy of a particular organisation. Under the open tendering system, as many suppliers as possible are usually invited through public advertisement to tender for the required goods and services. The selective tendering system on the other hand does not permit open competition. Only a few suppliers specialising in a particular field are selected and invited to submit tenders in their area of specialisation. The tenders submitted are collated and evaluated for the purpose of determining award prices. The tendering system is very common with government establishments. Such departments usually set up committee known as Tenders Boards for the purpose of opening tenders, evaluation and fixing prices.

5) Negotiation: In this case, it must be noted that price is not the only subject covered by negotiations. Even though price is a major consideration in all negotiations; other factors such as quality, quantity, delivery schedule and service are negotiable. Negotiation is a complex process which requires some strategies and tactics for its success.

3.3.2 Factors Influencing Price Setting

Many factors influence price and pricing strategy and operate at the environmental, organisational and strategic levels of any business firm. Some of those factors as identified by Needle (1992, pp. 230-232) are dealt with here under the following headings;

1) Cost

A useful way to consider costs is according to whether the sum is fixed or variable. Fixed cost is the sum total of costs that do not change when organisational output increases or decreases. Variable cost is the total of those costs, which change when the organisational output change i.e. expenses for raw materials. A business firm wishing to make a profit must use the cost of making a product or providing a service as an important base point in setting its prices.

2) Consumer Behaviour

The price of a product may well be related to what a consumer can afford and what he is prepared to pay. These in turn are related.

1) Income levels;

2) The consumer’s perceptions of quality and value for money; and

3) The consumer’s budget for a particular purchase.

3) Economic Factors

Price is related to the economy in a number of different ways, all of which have a potential impact on an organisation’s pricing policy. The affluence of consumers will have an obvious influence on their level of budgeting, and regional variations in consumers’ affluence may produce differential demand, especially for certain luxury items. The role of the state in managing the economy may affect both demand and prices. During the periods of high inflation, the government may well introduce measures to control prices.

4) Competition

Many business firms price their products by reference to an existing market, basing their price around that offered by competitors for products of similar features and quality. When the prevailing market condition is keenly competitive, the demand for a business firm’s product is perfectly elastic that is, the firm can sell its products only at or near the market price.

5) Management Goals

The price of goods is often related to the extent to which management wishes to optimize profit. The desire of a group of managers for a larger market share for their products may result in a low price strategy to build up demand.

6) Organisational Size

The size of an organization may give it market power and the ability to manipulate market price. This is especially true of few sellers or Oligopolies (*oligos* means few in Greek). A major fast food chain such as Mr. Biggs is able, because of its purchasing power and stock turnover, to insist on large price discounts from its suppliers.

3.5 The Use and Importance of Discounts in Procurement

Industrial purchases are usually subject to cash, trade, and quality discounts. Procurement agents and buyers must be thoroughly acquainted with these discounts as they apply to the purchases that they are making – and with the legal aspects of same. Technically; A discount is a percentage variation to the nominal price. It involves the offer of reductions (differentials) from a base price and must also be considered when price policy is being determined. By using a system of discounts, sellers can modify the prices without having to set new list prices.

3.5.1 Types of Discounts

The criteria for supplier discounts are many and it may be an exercise in futility to attempt to identify and describe all of them. The following are however the most usual forms:

1) Trade Discount

The trade (also sometimes called functional) discounts are price reductions given to various classes of buyers and distributors to compensate them for performing certain marketing functions for the original seller (the manufacturer) of the product. Ordinarily the amount of a buyer's discount depends upon whether he is a wholesaler, an industrial purchaser, or a retailer. Discounts are lowest for the retailer and highest for the wholesaler.

2) Quantity Discounts

The quantity discount is offered on the basis of the amount of the commodity purchased. These are price reductions given to a buyer for purchasing increasingly larger quantities of materials. Quantity discounts may be cumulative or non cumulative these are explained as follows: **Cumulative quantity discounts** are based upon purchases made from a single source during a prescribed period of time, such as six months. **Non-cumulative discounts,** which are more common, apply only to a single purchase.

Quantity discounts, whatever their form, offer definite advantages. From the manufacturer's viewpoint, the following advantages are notable:

1) They encourage purchasers to buy more frequently from a single vendor,

2) They stimulate larger order, and

3) They result in increased production units, since voluminous production is made possible by the increased demand.

From the buyer's viewpoint, quantity discounts are advantageous because:

1) He is able to buy at lower net prices.

2) The ultimate consumer and the industrials consumers also benefit from the decreased price level those results.

Quantity discount also have disadvantages.

1) Producer: overestimating the savings that may result from obtaining a large order, may allow too much discount.

2) Moreover: small-scale buyers may resent the fact that lower net prices are offered to large-scale purchasers.

3) Cash discounts: A cash discount is offered for payment of bills in advance of the due date. Most business transactions from manufacturer to different classes of buyers are conducted on credit terms. The length of time allowed for payment varies considerably and payment in practice is often delayed beyond the duration of the officially stated credit terms.

4) Seasonal discounts: Based on the seasonal nature of some products (primarily consumer products), their producers commonly offer discounts for purchases made in the off-season. A seasonal discount is thus offered to stimulate the purchase of seasonal goods during "off-peak" period.

The **objectives are** to;

(a) Move the seasonal produce of the seller out of warehouse and,

(b) To maintain a move balanced production throughout the year in order to reduce overhead costs

5) Geographical differentials: These are price variations offered in relation to distance from supply base e.g. new car delivery.

6) Special discounts: Many discounts fall within this category. They are special discounts made available by vendors or suppliers only by exceptional and special or temporary circumstances.

3.5.2 Use of Discounts

From the foregoing discussion, it may be summarized that discounts are offered for four main reasons: (1) To obtain prompt payment

(2) To change prices without reprinting price lists.

(3) To give special terms to special classes of customer

(4) To induce customers to buy large quantities.

3.6 Procurement Timing Policies and Inventory Management

One of the primary roles of purchasing is to ensure adequate supply of materials and components of acceptable quality in the most cost-effective manner. The procurement function has since realised the existence of the numerous problems affecting certain commodities and the characteristic of such markets. Purchasing therefore, faced this situation must formulate fundamental policy decisions on either:

• Buying for the purpose meeting immediate needs;

• Buying according to the dictate of the markets.

1) Buying for Immediate Requirements

This type of policy stipulates that materials are brought into the organisation only when the need arises. This action implies that more emphasis is placed on inventory levels rather than on prices of materials, since commodities are subject to price fluctuations or forces of demand and supply. Buyers take the advantage of lower prices to stock goods in excess of their immediate requirements. This policy option therefore, requires that, purchases can only be made regardless of whatever the selling prices are, at the time of purchase.

2) Buying according to the dictates of the market

This policy option takes into consideration the market situation affecting prices of goods such as seasonal fluctuation, or actions of the market. Buyers that select this option may have chosen between the following market activities:

(a) Hand-to-mouth buying

(b) Speculative buying

(c) Forward buying.

(a) Hand-to-Mouth Buying

This is the practice whereby buyers engage in buying to satisfy immediate requirement especially when prices are considered to be high. It is a policy frequently used in difficult trading periods, or when a company wants to conserve its financial resources. The principle is to buy exact need and save money, rather than buying in excess of immediate needs when prices are high.

(b) Speculative Buying

This practice involves buying in anticipation of future rise in prices. If the price of certain commodity is known to be capable of unexpected fluctuation or the availability of such commodity is not certain, speculative purchase of such commodity may be considered prudent. This type of buying therefore refers to buying in excess of immediate requirements in order to take the advantage of lower prices or unforeseen scarcity.

(c) Forward Buying.

This is the practice of buying materials in excess of current requirement, but not beyond the actual foreseeable requirements. The objective of forward buying policy is to take care of well-defined production requirement, especially in a situation where materials scarcity or price increase is foreseeable in the nearest future. Some of the advantages of forward buying are: 1) It enables the buyer to know the production cost of an item before they embark on the production activities; 2) It also reduces the risk of inadequate delivery in a period of materials shortage or scarcity.

SELF ASSESSMENT EXERCISE

State the general methods used in price determination.

4.0 CONCLUSION

Obtaining materials at the right price is important. It literally can mean the difference between a firm's success or failure. This is a major responsibility of the purchasing group. Many factors influence what is a right price; even though it is hardly possible to comprehensively discuss this. But this clarification must be made because of the erroneous idea that the price level is of little importance in industrial buying decision-making process. With the traditional approach to purchasing, it is easy for the importance of price to be over-looked.

Purchasing should ideally aim for the right price; this is a price which gives the best value to the organisation, taking quality, delivery and relative urgency into account. This may not always be the lowest price available, but the one, which represents the best value over a period of time. Professional buyers commonly interpret the right price as one that is fair and reasonable to both the buyer and seller. Unfortunately, no single set of pricing principles or criteria exist for calculating precisely what constitutes a fair and reasonable price. The right price from one vendor is not necessarily the right price from all other vendors, at either the same or at different points in time. To determine the right price, for any specific purpose, a number of constantly changing variables and relationships must be evaluated.

5.0 SUMMARY

Price is important both to the seller and the buyer, but it is regarded as only one of the elements in the marketing mix. As it is used in purchasing, price is the mechanism for measuring the value of goods and services in monetary terms. As stated earlier, the right price is not always the lowest price available. The purchasing group may have occasions to suspect a low quotation particularly where: (1) It may entail reduction in quality and service levels or; (2) Where it may lead to right final costs in the end. Whether a particular price is to be considered the right one or not depends on the situation. There are times when a low quotation may result from a deliberate action of a particular supplier. The buyer must take advantages of such pricing opportunities after satisfying himself that the low prices are not designed to reduce quality and service levels. On the other hand, market condition may justify buying at a high price in order: (1) to avoid buying at anticipated higher prices later. (2) similarly, such a high price may reflect the superior quality and services level of the vendor, which cannot be compromised. It therefore follows from the above that the buyer must be thoroughly familiar with market gimmicks.

6.0 TUTOR-MARKED ASSIGNMENT

Summarise the reasons for offering discounts in purchasing.

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UNIT 6 TERMS OF PAYMENT FOR GOODS----------------------------63

Content

1.0 INTRODUCTION

The elements of price included in the quotation of a tenderer depend on the nature of the goods to be supplied and the allied services to be performed, location of the supplier, location of the user, terms of delivery and regulations about taxes, duties, etc. of the seller's country and the buyer's country. In case of indigenous goods, the main elements of price are raw material price, production cost, overhead, packing & forwarding charges, margin of profit, transit insurance, excise duty and other taxes and duties as applicable.

In case of imported goods, in addition to similar elements of price as above (other than excise duty and taxes), there may be elements of custom duty, import duty, landing and clearing charges and commission to Indian agents. Further, depending on the nature of the goods (whether domestic or imported), there may be cost elements towards installation & commissioning, operator's training etc.

It is, therefore, necessary that, to enable the tenderers to frame their quotations properly in a meaningful manner, the tender documents should clearly specify the desired terms of delivery and, also the duties and responsibilities to be performed by the supplier in addition to supply of goods.

Where the price has several components like price of the goods, costs for installation & commission, operators' training etc. the tenderers should be asked to furnish the cost break-up indicating the applicable prices for each such component (as specified and desired in the tender enquiry document) along with the overall price. This unit discusses the terms of payment for all categories of purchased goods.

1.0 OBJECTIVE

At the end of studying this unit, you should be able to;

4) Discuss the issues involved in the payment terms for domestic goods
5) Explain the related issues of terms of payment for imported goods in different situations

3.0 TERMS OF PAYMENT FOR GOODS

3.1 Terms of Payment for Domestic Goods

Where the terms of delivery is FOR Despatching Station, the payment terms, depending on the value and nature of the goods, mode of transportation etc may be – 60% to 90% on proof of despatch and other related documents and balance on receipt at site and acceptance by the consignee. Where the terms of delivery is CIP destination/delivery at site/FOR destination, usual payment term is 100% on receipt and acceptance of goods by the consignee and on production of all required documents by the supplier.

Where goods to be supplied also need installation and commissioning by the supplier, the payment terms are generally as under:

i) For a contract with terms of delivery as FOR despatching station – 60% on proof of despatch along with other specified documents, 30% on receipt of the goods at site by the consignee and balance 10% on successful installation and commissioning and acceptance by the consignee.

ii) For a contract with terms of delivery as CIP destination/Delivery at site/FOR destination – 90% on receipt and acceptance of goods by the consignee at destination and on production of all required documents by the supplier and balance 10% on successful installation and commissioning and acceptance by the consignee.

It must however be noted that generally, (especially for goods requiring installation and commissioning at site by the supplier), the desirable terms of delivery are CIP destination or Delivery at site, so that the supplier remains responsible for safe arrival of the ordered goods at the site. Therefore, unless otherwise decided Ex-works or FOR Despatching station terms should be avoided.

3.2 Terms of Payment for Imported Goods

3.2.1 **Cases where Installation, Erection and Commissioning (if applicable) are not the responsibility of the Supplier –** 100 % net FOB/FAS price is to be paid against invoice, shipping documents, inspection certificate (where applicable), manufacturers' test certificate, etc.

3.2.2 **Cases where Installation, Erection and Commissioning are the responsibility of the Supplier –** 80% - 90% net FOB/FAS price will be paid against invoice, inspection certificate (where applicable), shipping documents etc. and balance within 21 - 30 days of successful installation and commissioning at the consignee's premises and acceptance by the consignee.

3.2.3 **Payment of Agency Commission against FOB/FAS Contract –** Entire 100% agency commission is generally paid after all other payments have been made to the supplier in terms of the contract.

3.2.4 Payment of Air Freight Charges

Goods that are required to be air lifted are to be despatched through any of the operating Airlines in Nigeria on a `Charge forward basis'. All air freight charges, which are shown on the relevant consignment note as chargeable to the consignee, are to be paid to airliner in naira term.

3.2.5 Advance Payment to Supplier

Ordinarily, payments for supplies made or services rendered should be released to the supplier only after the supplies have been made or services have been rendered. However, it may become necessary to make advance payments in the following types of cases: -

(i) Advance payment demanded by firms holding maintenance contracts for servicing of Air-conditioners, computers, other costly equipment, etc.

(ii) Advance payment demanded by firms against fabrication contracts, turn-key contracts etc.

Such advance payments should not exceed the following limits:

(i) Thirty per cent of the contract value to private firms;

(ii) Forty per cent of the contract value to a State or Federal Government agency or a Public Sector Undertaking;
(iii) In case of maintenance contract, the amount should not exceed the amount payable for six months under the contract.

In exceptional cases, the Ministries or Departments may, in consultation with their Financial Advisers, relax the ceilings mentioned above. However, while making any such advance payment, adequate safeguards in the form of bank guarantee etc. should be obtained from the supplier. Further, such advance payments should be *generally* interest bearing, suitable percentages for which are to be decided on case to case basis.

3.2.6 Documents for Payment

The documents, which are needed from the supplier for release of payment, are to be clearly specified in the contract. The paying authority is also to verify the documents received from the supplier with corresponding stipulations made in the contract before releasing payment. The important documents, which the supplier is to furnish while claiming payment, are:

a) Original Invoice
b) Packing List
c) Certificate of country of origin of the goods to be given by the seller or a recognized Chamber of Commerce or other agency designated by the local Government for this purpose.
d) Certificate of pre-despatch inspection by purchaser's representative
e) Manufacturer's test certificate
f) Certificate of Insurance
g) Bill of lading/Airway bill/Rail receipt or any other despatch document, issued by a government agency (like the Department of Posts) or an agency duly authorized by the concerned Ministry / Department.
h) Product is new, un-used and also meets the other relevant contractual requirements.

While claiming payment, the supplier is also to certify in the bill that the payment being claimed is strictly in terms of the contract and all the obligations on the part of the supplier for claiming this payment has been fulfilled as required under the contract. There should also be a suitable provision for verification of the authenticity of the person signing the invoice etc. for claiming the payment.

3.2.7 Modes of Payment

3.2.7 (a) Payment to Domestic Suppliers

Payments to domestic suppliers are usually made by cheque/demand draft drawn on a Government treasury or branch of the Central Bank of Nigeria or commercial bank in Nigeria transacting government business. Such payment can also be made to the supplier’s bank, if the bills are endorsed in favour of the bank with a pre-receipt embossed on the bills with the words, "Received payment" and both the endorsement and pre-receipt are authenticated by the supplier. In addition, an irrevocable power of attorney is to be granted by the supplier in favour of the bank. In such of those cases where there has been global tendering, in order to have uniform payment clauses, if domestic suppliers, especially against high value contracts for sophisticated equipment/machinery, desire payment through Letter of Credit, the same, depending on the merits of the case may be agreed to.

3.2.7 (b) Payment to Foreign Suppliers

Payment to foreign suppliers are ordinarily made by Letters of Credit (LC) opened by the central bank of Nigeria or any other scheduled/authorized Bank as decided by the purchasing Ministry/Department. While opening the Letters of Credit, the Ministry/Department should follow the provision of Uniform Customs and Practices for Documentary Credit (UCPDC). If Letter of Credit is not opened, payment can also be made to the seller through Direct Bank Transfer for which buyer has to ensure that payment is released only after the receipt of prescribed documents.

3.2.7 (c) Payment by Letter of Credit

Two banks are involved for payment to the supplier by Letter of Credit – purchaser’s bank and supplier’s bank. The purchaser is to forward the request to its bank in the prescribed format as formulated by central bank of Nigeria, along with all relevant details including authenticated copy of the contract.

Based on the same, the purchaser’s bank opens letter of credit on behalf of the purchaser for transacting payment to the supplier through the supplier’s bank. Care should be taken to ensure that the payment terms and the documents to be produced for receiving payments through letter of credit are identical with those shown in the contract. Generally, irrevocable letter of credit is opened so that the supplier is fully assured of its payment on fulfilling its obligations in terms of the contract. In case, the delivery date of the contract is extended to take care of delay in supply, for which supplier is responsible, the tenure of the letter of credit is also to be extended, but the expense incurred for such extension (of letter of credit) is to be borne by the supplier.

3.2.7 (d) E - Payment

E - Banking and E - Payments are now used by various banks by adopting Electronic Clearing System (ECS) and Electronic Fund Transfer (EFT) procedure. Payments to suppliers may be made through such mechanism where such facilities are available.

3.2.8 Recovery of Public Money from Supplier's Bill

Sometimes, requests are received from a different Ministry/ Department for withholding some payment of a supplier out of the payment due to it against a contract. Such requests are to be examined by the Ministry/Department (which has received the request) on the merits of the case for further action. It will however, be the responsibility of the Ministry/Department asking for withholding of payment to defend the Government against any legal procedure arising out of such withholding as also for payment of any interest thereof.

3.2.9 Refund from Supplier

Sometimes, the suppliers, after claiming and receiving reimbursements for sales tax, excise duty, custom duty etc. from the purchaser, applies to the concerned authorities for refunds, on genuine grounds, of certain portions of such duties and taxes paid by it and receives the allowable refunds. Such refunds contain the purchaser's share also (out of the payments already made by the purchaser to that supplier). The tender enquiry document and the contract are to contain suitable provisions for obtaining such refunds from the supplier.

3.2.10 Payment against Time Barred Claims

Ordinarily, all claims against Government are time barred after a period of three years calculated from the date when the payment falls due unless the payment claim preferred has been under correspondence. However, limitation is saved if there is an admission of liability to pay, and fresh period of limitation starts from the time such admission is made. The drill to be followed while dealing with time barred claims will be decided by the Ministry/Department concerned in consultation with the Paying Authority. The Paying Authority is to ensure that no payment against such time barred claim is made till a decision has been taken in this regard by the competent authority.

4.0 CONCLUSION

To achieve what has been stated in the above paragraphs, it is essential that the purchase officials be provided with all the required rules, regulations, instructions, directives, and guidance on best practices in the form of a Manual. The manual should contain guidelines and directives concerning purchase of goods with public funds as well as some allied areas such as installation of equipment, operators' training, after sales services, maintenance contract, etc. Relevant aspects of purchase
management techniques have been incorporated in proper sequence under separate chapters.

5.0 SUMMARY

While claiming payment, the supplier is also to certify in the bill that the payment being claimed is strictly in terms of the contract and all the obligations on the part of the supplier for claiming this payment has been fulfilled as required under the contract. There should also be a suitable provision for verification of the authenticity of the person signing the invoice etc. for claiming the payment. Generally, irrevocable letter of credit is opened so that the supplier is fully assured of its payment on fulfilling its obligations in terms of the contract.

In case, the delivery date of the contract is extended to take care of delay in supply, for which supplier is responsible, the tenure of the letter of credit is also to be extended, but the expense incurred for such extension (of letter of credit) is to be borne by the supplier.

6.0 TUTOR MARKED ASSIGNMENT

The documents, which are needed from the supplier for release of payment, are to be clearly specified in the contract. What are these documents? Explain each one.

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UNIT 7: MODES OF PURCHASE, RECEIPT AND OPENING OF TENDERS---------------70

Content

1.0 INTRODUCTION

Public buying should be conducted in a transparent manner to bring competition, fairness and elimination of arbitrariness in the system. This will enable the prospective tenderers to formulate competitive tenders with confidence. The specifications of the required goods should be framed giving sufficient details in such a manner that it is neither too elaborately restrictive as to deter potential tenderers or increase the cost of purchase nor too sketchy to leave scope for sub-standard supply. The specifications must meet the essential requirements of the user department. Efforts should also be made to use standard specifications, which are widely known to the industry. In this unit, you will be exposed to the various modes of purchase to be adopted in any given transaction.

2.0 0BJECTIVES

At the end of studying this unit, you should be able to;

- Outline and explain in clear terms the various modes of purchase to be adopted in any given transaction.

3.0 MODES OF PURCHASE, RECEIPT AND OPENING OF TENDERS

3.1 General

Depending on the nature of the required goods, the quantity & value involved and the period of supply, the purchase organization is to decide the appropriate mode of purchase. The various modes of purchase to be adopted for this purpose are indicated in the subsequent paragraphs.

3.1.1 Approval of the competent authority to the purchase

Demand for Goods should not be divided into smaller quantities for making piece meal purchases for the sole purpose of avoiding the necessity of obtaining the sanction of higher authority required with reference to the estimated value of the total demand.

3.1.2 Purchase of Goods without Quotation

Purchase of goods upto a value of =N= 15,000 (Fifteen Thousand only) on each occasion may be made without inviting quotations/bids by the competent authority on the basis of a certificate to be recorded by him in the following format:

> "I, ________ am personally satisfied that these goods purchased are of the requisite quality and specification and have been purchased from a reliable supplier at a reasonable price."

3.1.3 Purchase of goods by Purchase Committee

Purchase of goods costing above =N= 15,000 (Fifteen Thousand only) and up to =N=1,000,000 (=N= One million naira only) on each occasion may be made on the recommendations of a duly constituted Local Purchase Committee consisting of three members of an appropriate level as decided by the Head of Department. The committee will survey the market to ascertain the reasonableness of rate, quality and specifications and identify the appropriate supplier. Before recommending placement of the purchase order the members of the committee will jointly record a certificate as under:

> "Certified that we ________________, members of the purchase committee are jointly and individually satisfied that the goods recommended for purchase are of the requisite

specification and quality, priced at the prevailing market rate and the supplier recommended is reliable and competent to supply the goods in question."

3.1.4 Purchase of Rate Contracted Goods

The Central Purchase Organization (e.g. DGS&D) will conclude rate contracts with the registered suppliers, for goods and items of standards types which are identified as common user items and are needed on recurring basis by various Ministries / Departments. The Central Purchase Organization (e.g. DGS&D) is to post the specifications, prices and other salient details of different rate contracted items, appropriately updated, on its web site for use by the procuring Ministries / Departments. The Ministries / Departments are to operate those rate contracts to the maximum extent possible. In case a Ministry / Department directly procures Central Purchase Organization's (e.g. DGS&D's) rate contracted goods from suppliers, the prices to be paid for such goods shall not exceed those stipulated in the rate contract and the other salient terms and conditions of the purchase should be in line with those specified in the rate contract. The Ministry / Department shall make its own arrangement for inspection and testing of such goods where required.

3.1.5 Preferential / mandatory purchase from certain sources or price preference to certain suppliers

As indicated eaarlier, Government has prescribed mandatory or preferential purchase of specified goods from specified suppliers or extension of price preference to certain categories of suppliers. *While making purchase of goods falling in these categories, the purchase organization should check the contemporary directives in this regard for necessary action.*

3.1.6 Purchase of Goods financed by Loans/Grants extended by International Agencies

The Articles of Agreement with the International Agencies, like the World Bank, Asian Development Bank etc. stipulate specific procurement procedures to be followed by the borrowers. The procurement procedures, as finalized and incorporated in the Agreements after consideration and approval of the Ministry of Finance are to be followed accordingly.

3.1.7 Purchase of Goods by obtaining Tenders

Except for the purchase of goods through the methods given in the preceding paragraphs, Ministries/ Departments shall procure goods within their delegated powers by following the standard method of obtaining tenders as follows:

(i) Advertised Tender Enquiry (ATI)

(ii) Limited Tender Enquiry (LTI)

(iii) Single Tender Enquiry (STI)

3.1.8 Advertised Tender Enquiry (ATI)

Subject to exceptions incorporated under the Limited Tender Enquiry and Single Tender Enquiry below, invitation to tenders by advertisement should be used for procurement of goods of estimated value into millions of naira and above. Advertisement (in the form of a Tender Notice) relating to ATI should be given in the national Trade Journal (ITJ) published by the Director General of Intelligence and Statistics and at least in one national daily having wide circulation. Further, an organization having its own web site is also to publish all its tender notices (relating to ATIs) on its own web site and provide a link with NIC web site. Additionally, for wider publicity, all Ministries / Departments should also publish their tender notices in the web site of Central Purchase Organization (e.g. DGS&D).

Where the Ministry / Department feels that the goods of the required quality, specifications etc., may not be available in the country and/or it is also necessary to look for suitable competitive offers from abroad, the Ministry/Department may send copies of the tender notice to the Nigerian Embassies abroad as well as to the Foreign Embassies in Nigeria requesting them to give wide publicity of the requirement in those countries.

They may also be requested to put the tender notice in their web sites. The selection of the embassies will depend on the possibility of availability of the required goods in such countries. Publicizing the requirement globally as above is also known as **Global Tender Enquiry**.

Ordinarily, the minimum time to be allowed for submission of bids should be three weeks from the date of publication of the tender notice or availability of the bidding document for sale, whichever is later. Where the department also contemplates obtaining bids from abroad, the minimum period should be kept as four weeks for both domestic and foreign bidders.

3.1.9 Text of Tender Notice

The tender notice for an ATI should be carefully drafted. It should contain all the salient features of the requirement in brief to give a clear idea to the prospective tenderers about the requirements. Superfluous or irrelevant details should not be incorporated in the tender notice, as it will increase the cost of the advertisement. The Tender Notice should contain:

- Description and specification of the goods and quantity
- Period and terms of delivery
- Cost of the tender/bidding document

- ♦ Place(s) and timing of sale of tender documents
- ♦ Place and deadline for receipt of tenders
- ♦ Place, time & date for opening of tenders
- ♦ Amount & Form of Bid Security / Earnest Money Deposit
- ♦ Any other important information

3.1.10 Cost of Tender Documents

Price of the tender document should take care of the preparation and delivering cost only. If it is too high, it will discourage the prospective bidders to purchase the document and participate in the bidding process.

3.1.11 Sale of Tender Documents

Tender documents should preferably be sold upto one day prior to date of opening of tenders and the same should be clearly indicated in the documents. The organization should also post the complete tender document in the web site and permit prospective tenderers to make use of the document downloaded from the web site. If the tender document is a priced one, there should be clear instructions for the tenderers in the document (which has been downloaded) to pay the amount by demand draft etc. along with the tender, prepared in the downloaded document.

The sale of tender documents against ATI should not be restricted and should be available for sale freely. The purchase organization shall maintain proper records about the number of tender documents sold, list of parties to whom sold, details of the amount received through sale and, also, the number of unsold tender documents, which are to be cancelled after the opening of the tenders.

3.1.12 Limited Tender Enquiry (LTI)

This method may be adopted when estimated value of the goods to be procured is up to millions of naira. Copies of the bidding document should be sent, free of cost, directly by speed post/registered post / courier/e-mail, simultaneously to all the firms, which are borne on the list of registered suppliers for the goods in question. The number of supplier firms in LTI should be more than three. Efforts should be made to identify a higher number of approved suppliers to obtain more responsive bids on competitive basis. Web site publicity should also be given for LTIs; however, the Ministry / Department can limit the access of the tender documents to only the selected prospective suppliers by issuing them password to have access to the document.

Purchase through LTI may be adopted even when the estimated value of the procurement is more than millions of naira, in the following circumstances:

(a) The competent authority in the Ministry / Department certifies that the demand is urgent and any additional expenditure involved by not procuring through advertised tender enquiry is justified in view of urgency. The Ministry / Department should also put on record the nature of the urgency and reasons why the procurement could not be anticipated earlier.

(b) There are sufficient reasons, to be recorded in writing by the competent authority, indicating that it will not be in public interest to procure the goods through advertised tender enquiry.

(c) The sources of supply are definitely known and possibility of fresh source(s) beyond those being tapped is remote.

(d) Nature of items to be procured is such that pre-verification of competence of firm is essential, hence requires registration of firms. Sufficient time should be allowed for submission of bids in Limited Tender Enquiry cases.

3.1.13 Pre-bid Conference

In case of turn-key contract or contract of special nature for purchase of sophisticated and costly equipment, a suitable provision is to be kept in the tender enquiry document for a pre-bid conference for clarifying issues and clearing doubts, if any, about the specification and other allied technical details of the plant, equipment and machinery projected in the tender enquiry document.

The date, time and place of pre-bid conference should be indicated in the tender enquiry document for information of the interested tenderers. This date should be sufficiently ahead of tender opening date.

3.1.14 Format of Tender

The tenderers are to furnish their quotations as per the prescribed format and also as per the instructions incorporated in the tender documents. Quotations sent by telex, cable or facsimile are to be ignored and rejected.

3.1.15 Sealing and Marking of Tenders

The tender document is to indicate the total number of tender sets (e.g., in duplicate or in triplicate etc) required to be submitted. The tenderer is to seal the original and each copy of the tender in separate envelopes, duly marking the same as “original”, “duplicate” and so on and also putting the address of the purchase office and the tender reference number on the envelopes. Further, the sentence ‘’NOT TO BE OPENED” before……….. (due date & time of tender opening) are also to be put on these envelopes. The inner envelopes are then to be put in a bigger outer envelope, which will also be duly sealed marked etc. as above. If the outer envelope is not sealed and marked properly as above, the purchaser will not assume any responsibility for its misplacement, premature opening, late opening etc. All the above instructions are to be suitably incorporated in the tender documents.

3.1.16 Extension of Tender Opening Date

Sometimes, situations may arise necessitating modification of the tender documents already issued (LTI case) or already put on sale (ATI case). Also, after receiving the documents, a tenderer may point out some genuine mistakes necessitating amendment in the tender documents. In such situations, it is necessary to amend/modify the tender documents suitably prior to the date of submission of bids. Copies of such amendment / modification should be simultaneously sent to all the selected suppliers by registered/speed post/courier/e-mail in case of LTI. In case of ATI, the copies of such amendment / modification are to be simultaneously despatched, free of cost, by registered/speed post/courier/e-mail, to all the parties who have already purchased the tender documents and copies of such amendments are also to be prominently attached in the unsold sets of the tender documents (which are available for sale), including the tender documents put in the web site.

When the amendment/modification changes the requirement significantly and /or when there is not much time left for the tenderers to respond to such amendments, and prepare revised tender, the time and date of submission of tenders are also to be extended suitably, along with suitable changes in the corresponding time-frames for receipt of tender, tender validity period etc and validity period of the corresponding EMD/bid security. Depending on the situation, such an amendment may also need fresh publication adopting the same procedure as for publication of the original tender enquiry.

3.1.17 Amendments / Modifications to Tenders

The tenderer, after submitting its tender, is permitted to submit alterations/modifications to its tender so long such alterations/modifications are received duly sealed and marked like original tender, upto the date & time of receipt of tender. Any amendment/modification received after the prescribed date and time of receipt of tenders are not to be considered.

3.1.18 Receipt and Custody of Tenders

Receipt and custody of tenders shall be done in a transparent manner. Tenders are to be received though tender box and, in its absence, by hand delivery to the nominated officials of the purchase department. The tender box should be located in a place, which is easily accessible to the parties for dropping their tenders. The tender box shall have two locks. Key of one lock will be with the head of the office and the other key with the official nominated by him. On each occasion of tender opening, the tender box will be opened by two officials at the prescribed date and time (as per the date & time specified for receipt of tenders) and the relevant tenders will be taken out. In the tender box, there may be tenders for other cases due for opening later; such tenders are to remain in the tender box under lock and key. The tenders so taken out are to be entered in a gazette in duplicate duly signed with date and time by the two officials and sent to the officials authorized to open the tenders. Signatures of the receiving officials will be obtained on the duplicate copy of the challan for record. There should be at least two officials nominated for opening of tenders.

There may be cases where the tenders are too bulky to be put in the tender box or the purchase office is yet to install tender box and, therefore, the tenders are to be submitted by hand. In such cases, it should be ensured that names and designations of at least two officers, who will receive the tenders, are prominently mentioned in the tender documents. The information about these officers should also be displayed at the entrance / reception of the premises where tenders are to be deposited. The officer receiving a tender is to give the bearer of the tender a receipt duly signed by him with date and time of receipt of the tender.

A separate register is to be maintained for keeping records of the bids, received by hand. Such bids will be kept in safe custody with the head of the office or his authorized representative till the date and time of bid opening and then such bids will be handed over to the bid opening officer, in identical manner as mentioned in the previous paragraph. Sometimes, tenders are also received by post. Such tenders shall be received and documented in identical manner as applicable for tenders received through hand delivery.

3.1.19 Late Tender

In the case of advertised tender enquiry or limited tender enquiry, late tenders (i.e., tenders received after the specified date and time for receipt of tenders) should not be considered.

3.1.20 Opening of Tenders

All the tenders received on time shall be opened in the presence of authorized representatives of the tenderers (who have submitted regular tenders) at the prescribed time, date and place. The authorized representatives, who intend to attend the tender opening, are to bring with them letters of authority from the corresponding tenderers. Tenders should be opened immediately after the deadline of receipt of tenders with minimum time gap in between. At least two duly authorized officials of the purchase department should jointly open the tenders. The tender opening officials are to announce the salient features of the tenders like description and specification of the goods, quoted price, terms of delivery, delivery period, discount if any, whether EMD furnished or not and any other special feature of the tender for the information of the representatives attending the tender opening.

After opening, every tender shall be numbered serially, initialled, and dated on the first page by all the officials authorized to open the tenders. Each page of the price schedule or letter attached to it shall also be initialled by them with date, particularly the prices, delivery period etc., which shall also be circled and initialled with date. Blank tenders, if any, should be marked accordingly by the tender opening officials. The original, duplicate, triplicate copies in a tender set are to be marked accordingly by the tender opening officials.

Alterations in tenders, if any, made by the tenderers, shall be initialled with date & time by the officials opening the tenders to make it perfectly clear that such alterations were present on the tenders at the time of opening. Wherever any erasing or cutting is observed, the substituted words should also be encircled and initialled with date & time to make clear that such erasing/cutting of the original entry was present on the tender at the time of opening.

3.1.21 Responsibility of the Tender Opening Officials

In addition to what has been mentioned above, the tender opening officials will prepare a list of the representatives attending the tender opening and obtain their signatures on the same. The list will also contain the representatives' names and the corresponding tenderers' names and addresses. The authority letters brought by the representatives will be attached with this list. This list will be signed by both the tender opening officials with date & time.

An on-the-spot report containing the names of the tenderers (serial number wise) salient features of the tenders, as read out during public opening of tenders will be prepared by the tender opening officers duly signed by them with date & time. The tenders, which have been opened, the list of the representatives attending the tender opening and the on-the spot report are to be handed over to the nominated purchase officer and acknowledgement obtained for the same.

4.0 CONCLUSION

To achieve what has been stated in the above paragraphs, it is essential that the purchase officials be provided with all the required rules, regulations, instructions, directives, and guidance on best practices in the form of a book. This unit was focused to serve this objective.

5.0 SUMMARY

This unit contains guidelines and directives concerning purchase of goods as well as some allied areas such as installation of equipment, operators' training, after sales services, maintenance contract, etc. Relevant aspects of purchase management techniques have been incorporated in proper sequence under separate subsections. This arrangement will help you to readily achieve the knowledge necessary on the modes of purchase, receipt and opening of tenders.

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6.0 TUTOR MARKED ASSIGNMENT

How do you understand the concept of tender notice? What information should be contained in the tender notice?

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UNIT 8 PURCHASING PRACTICE AND METHODS – (I)------------------79

Contents

1.0 INTRODUCTION

Procurement has long been considered one of the basic functions common to all organisations. Retailers, wholesalers, and in certain cases, service establishments, buy merchandise to sell to their customer. Manufacturer purchase the materials they use in their production processes. In all cases, purchasing is vital to the success of the business; without an adequate supply of merchandise and / or materials, the firm would be unable to operate at maximum efficiency. A company procurement function becomes particularly important when: 1) Its purchased items account for a high proportion of the unit cost of the product. 2) When the price fluctuate widely 3) When numerous diverse items are needed 4) When the quality of the materials appreciably influences the cost of manufacturing. Regardless of the type of business, procurement and supply work is divided naturally into five distinct classifications, each of which encompasses a fairly wide range of activities. The five classifications of works found in a procurement operation are:

1) Management Management of the purchasing function involves all the tasks associated with the management process.

2) Buying This includes a wide variety of activities, such as working with users to help develop requirements and specifications, reviewing requisitions, analysis specification, investigating supplier, studying costs and prices, analysis of bids and negotiation and selecting suppliers. Some companies have expanded the buying job and now see it as supplier management.

3) Follow-Up and Expediting Other follow-up activities involves various types of supplier liaison work, such as reviewing the status of orders, writing letter, telephoning and faxing suppliers, and occasionally visiting supplier’s plant.

4) Strategic Planning and Research Work

The more an organisation progresses toward a purchasing management focus, the more emphasis it places on these strategic activities.

5) Clerical activities

Every department must write orders and must maintain working files, catalogue and library materials, and records for commodities suppliers, price and so on.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

1) state and explain how the need to procure different materials arise
2) discuss the issues involved in purchasing capital goods; in leasing arrangement; in buying used equipments, and in buying for resale
3) explain the meaning and factors influencing future dealing, sub-contracting and the purchase of services
4) highlight and comment on the keys to a successful service contract administration.

3.0 MAIN CONTENT

3.1 Origin of the Need to Purchase

Every purchase transaction originates with the recognition of the need for an item by someone in the enterprises. This need may originate in the department using the materials. The office manager may want a new typewriter. Quite often, the need for the material may be satisfied by transfer of materials from one to another department or drawing it from the stores. However, eventually the stores must replenish its supplies of the items issued to the user. Thus one may say that directly or indirectly, purchases originate from the recognition of need for an item by a user department. In regard to most items, an efficient purchasing department will anticipate the needs of user departments.

To however appreciate the range and variety of materials needed in an organisation, an examination of the wide range to needs that cover all types of business organisation whether in the private or public sector of the economy becomes very necessary. It is therefore possible to easily and broadly identify and discuss two bases for product classifications; the product based (goods and services) and the user-based (consumer and industrial goods).

3.1.1 Product Classification

There are many ways to categorise products, the most basic being to distinguish between goods and services. Another common approach among markets is to distinguish between consumer and industrial goods.

(a) Product-Based Classification: Product-based classification groups together products that have similar characteristics, although, they may serve different purposes and markets. There are three main categories:

(1) Durable Products: Durable products last for over a long period before having to be replaced.

(2) No-durable Products: Non-durable products can only be used once or for a few times before they have to be replaced.

(3) Service Products: Services represent intangible products comprising activities, benefits or satisfactions that are not embodied in physical product.

(b) User-Based Classification

This classification deals with consumer markets (goods purchased for personal or family consumption) and industrial or organisational markets (goods purchased for business or institutional use).

Industrial Goods and Services

Industrial products are goods purchased by organisations or institutions that are used in the process of manufacturing other goods. Those that are more expensive and have a longer useful life are considered capital items. Industrial goods are more usefully classified in terms of how they enter the production process and their relatively costliness. The following industrial items can be easily identified:

1) Capital Goods

Capital equipment consists of all the buildings and fixed equipments that have to be in place for production to happen. They are industrial goods that enter the finished product partly, and there are two group: installation and accessory equipment.

2) Raw Materials

These are industrial goods that enter the manufacturer's products completely. Raw materials arrive more or less in their natural state, having been processed only sufficiently to ensure their safe and economical transport to the factory. The raw material then go on to further processing within the purchaser's own production line.

3) Components and Parts

Components and parts are finished goods in their own right, which simply have to be incorporated into the assembly of the final product with no further processing. Car manufacturers for example buy in headlamp units, plugs, alarm system, and tyres as complete components or parts and then fit them to the cars on the assembly line.

4) Supplies and Services

There are several categories of minor consumable items (as distinct from the accessory goods) and service that facilitate production and the smooth running of the organisation without any direct input.

a) Operating Supplies: These are frequently purchased consumable items that do not end up in the finished products.

b) Maintenance and Repairs: These are industrial services that ensure that all the capital and accessory goods continue to operate smoothly and efficiently.

c) Business Services: These involve the purchase of service like management consultancy, accounting and legal advice and advertising agency expertise.

The above list is not exhaustive, but by examining its contents in terms of purchasing responsibilities in different organisations or industries, it becomes clear that needs must be recognized, authorised and satisfied in a variety of ways. In order to clarify this, it is first advisable to classify all requirements into groups, which have common characteristics and require similar treatment. All basic needs are thus classified into three main groups according to their common characteristic:

(a) Needs, which entail capital expenditure such as buildings, machines, vehicles, furniture, etc.

(b) Needs for production materials, which go directly into the finished product.

(c) Needs for miscellaneous suppliers, which are supplies other than production materials required to operate the business.

It can therefore be seen immediately that these three classes of needs will arise in different circumstances and at different place in the company.

3.1.2 Authority to Purchase

According to Menon K.S. (1993), when the aspects of authority in matters relating to purchases are discussed, there are usually two separate groups of people who are involved. They include:

1) The authority of the person who needs the items to make requisition for the item. This person may be the actual user (e.g. the plant foreman), or it may be the stores officer in charge of the stores where the item is stocked.

2) The second one is the authority vested in officers of the purchasing department for making purchase of the items required.

The authority to purchase is basically related to its status as a service department orientated towards catering for the supply requirements of various departments by making purchases of materials, equipments etc. which they need. There are three ways in which a user department or store authorises the purchasing department to make purchases for them:

• By means of a purchase requisition often called the materials indent form;

• By means of a permanent order card or travelling requisition.

• By means of a bill of materials or parts list made in conjunction with production department.

1) The Purchase Requisition When a department or store needs a particular material, which may be raw materials or equipment or stationery, it prepares a material requisition usually on the Materials Indents Form. This form is usually prepared in duplicate being retained by the requisitioning department for reference and follow-up. The purchase requisition should provide the following essential information:

(a) Specification
(b) Quantity
(c) Delivery
(d) Work Order Reference
(e) Materials Indent Form
(f) Signature

2) The Permanent Order Card or travelling requisition SS (TR)

This methods or requisitioning is used for materials purchased on repeat basis or for standard stock items, i.e., items which are stocked on a regular basis in the stores. This is a permanent card with all details on the materials recorded inside it. Each time a quantity is needed, the card is sent to the purchasing department indicating the quantity or volume required.

A Travelling Requisition (TR) on the other hand carries all relevant information required to enable the purchasing department to place orders for fresh supplies.

When stock level reaches the re-order level, the stock control clerk sends the TR to the purchasing department. When the TR is received, the purchasing department swings into action. It decides upon the source from which the purchase is to be made, as well as the quantity that is to be ordered, and then passes the card on for typing out the purchase order.

3) Bill of Materials or Part List

When the design department designs a particular product, a list of the various materials, which are required to make that particular product, is made out. This is called a Bill of Materials or Part List. When a production schedule is prepared, it is usually converted into a Bill of Materials which will show exactly what materials are required and when. The purchasing department can then establish the total material requirements and determine when exactly each would be required and in what quantities. In some cases, the Bill of Materials is routed to the purchasing department through the stock control department who will indicate which items on the list are regular stock items and which items have to be purchased. The purchasing department then takes out the remaining requirements from the bill of materials and places the purchase orders that are necessary.

3.2 Purchasing Capital Goods

Modern advanced industrial technology rests upon the use of vast amount of capital: elaborate machinery, large-scale factories and plants, stores and stocks of finished and unfinished materials.

Capitalism got its name because this capital or productive wealth is primarily the private property of somebody – the capitalist. Capital, which is the word often used to refer to capital goods generally, is a different kind of production factor. A capital good differs from the primary factor (such as land, labour) in that neither land nor (these days) labour is regarded as result of the economic process; but instead, exist primarily by virtue of physical and biological, rather than economic factors. Capital is on the other hand, an input which is itself the output of the economy. Capital goods then represent produced goods that can be used as factor input for further production. In most firms capital equipment is not purchased every day – but when it is, such represent important management decisions as a rule, these purchases are major investments.

1) Investments that lead to improved productivity, and or
2) To the manufacture of more competitive products that increase sales in the market place.

3.2.1 Factors to Consider in Buying Capital Equipment

Apart from the mode of purchase, finance and the investment made, Lysons, K (2000, p. 323) argued that the factors to be considered should include the following:

1) Purpose: what is the prime purpose of the equipment?
2) Flexibility: How versatile is the equipment.

3) Standardisation: is the equipment compatible with any already installed, thus reducing the cost of holding spares?
4) Life: This usually refers to the period before the equipment will have to be written off due to depreciation or obsolescence. It is, however, not necessarily linked to the total life span if it is intended to dispose of the asset before it is obsolete or unusable.
5) Reliability
6) Durability
7) Product quality
8) Cost of operation: Costs of fuel, power and maintenance.
(9) Cost of installation
10) Cost of maintenance
11) Miscellaneous
12) Life cycle costing (Terotechnology) is an important aspect of capital expenditure.

Chartered institute of Management Accountant (CIMA) has defined life cycle costing as:

The practice of obtaining over their life time the best use of the physical assets at the lowest cost to the entity (Terotechnology). This is achieved through a combination of management, financial, engineering and other disciplines.

The term **'Terotechnology'** coined in 1970 is derived from the Greek verb tereo and literally means 'the art and science of caring for things.' Life cycle costs are therefore those associated with acquiring, using, caring for and disposing of physical assets, including feasibility studies research, development, design, production, maintenance, replacement and disposal, as well as the associated support, training and operating cost incurred over the period in which the asset is owned.

3.2.2 Purchase and Product Characteristics of Capital Goods The role of the purchasing department is distinctly different in the buying activity of capital goods than it is in production buying. The peculiar characteristics of capital goods make both the purchase of capital equipments and the product itself differ in a number of ways. This includes:

(1) This fundamental difference between capital and non-capital goods is a time difference.

No capital goods represent expenditure on current needs, and goods of this kind are used up in a relatively short time. Capital goods represent investment in fixed as sets or capital assets, which will be used for a relatively long-time.

(2) Some of the items of capital goods are high specialised and are built in order to meet the needs of buyers: others are more or less standardised and are used by a number of different industries.

(3) Capital goods have initial high price, and commitment to one capital project means that others have to be turned down.

(4) In evaluating capital goods, buyer will consider such properties as productivity, versatility, durability, economy of operation and maintenance, and time and labour-saving features.

(5) Acquisition of capital goods is frequently subjected to the participation of various executives in the buying firm, because the equipment is of high value and of great significance to the buyer.

(6) Sales of capital goods are largely through direct buyers because of:

(a) The small numbers of users

(b) The concentration of the demand market

(c) The large unit of sale

(d) The need for most effective communications with sellers to enable speedy negotiation of particular needs

(e) The need to provide various types of service (e.g. installation advice the supply and training of operators).

(7) Another special characteristic is that expenditure on most capital goods is personable. Just as the individual consumer can postpone the replacement of his car or refrigerator until next year, so a manufacturing organisation can postpone the replacement of an old machine tool until prospect looks brighter or the financial situation is better.

(8) Creation of demand is difficult for the supplier or seller as the capital equipment will only be required in connection with new plant, for expansion or replacement.

(9) Most organisations use special requisition forms for capital purchases because of these special characteristics. The procedure for authorising the expenditure tends to be more formal; often a director’s signature is required.

3.2.3 The Role of Purchasing Department in the Procurement of Capital Goods

Peter Baily et al (1981:224) argued that the purchasing executive is the key figure in communications between his organisation and supplier. Although policy in regard of the purchasing department’s role varies widely between companies, one basic area of consideration is the calibre and competence of the people who constitute the department. Many small purchasing departments play a clerical role only, while others are able to make useful contributions to the whole process of considering, deciding upon, and actually undertaking the project.

Large organisations which employ substantial procurement personnel and make numerous purchases of plant and equipment usually have specialist buyers who have built up extensive market knowledge and considerable expertise in the negotiation and administrations of capital contract.

The procurement of capital equipment calls for purchasing personnel that functions in a creative capacity as facilitators and coordinators. David N. Burt et al (1996:399) summarized key points of purchasing role in a typical capital equipment purchase. This includes:

1) Participate in the preliminary discussion phase, including solicitation of information and budgetary estimates.

2) Review and request clarification of specifications. Specification must be precise and complete, and they must be written as functionally as possible.

3) Coordinate the development and qualification of potential supplier, including various qualitative analyses. The purchasing executive must first determine, usually with engineering assistance, the level of a supplier's technical and production capabilities. This is of utmost importance.

4) Compile required commercial terms and conditions.

5) Prepare and process the request for proposal from potential suppliers.

6) Coordinate the analysis of supplier proposal, including economic analyses and the resolution of any exceptions to specifications. Economic analysis of each machine must be made, relating its ultimate cost to its productivity. Several measures or profitability can be used, the payback approach being the most common or any of the more sophisticated discounting cash flow (DCF) approaches. Economic analyses must be thorough, and must be based on accurate data.

7) Arrange for side-by-side demonstration, if practicable.

8) Plan, coordinate, and conduct negotiations as necessary. After management has approved a proposal for the purchase of capital equipment, the buyer assumes his/her customary responsibility for negotiating the final price, and related terms of the contract.

9) Coordinate and conduct contract inspection and expediting services.

10) Critique and document supplier's performance by means of objective vendor rating exercise.

11) Maintain records of price and delivery trends for future procurements.

The purchasing executive contributes directly to the accomplishment of some of these activities. More important, however is his or her responsibility to orders and coordinate the total performance. The buyer's main job is to ensure that every thing happens as it should.

3.3 Acquisition of Used Equipment

A buyer is by no means restricted to the purchase of new capital equipment. The existing used equipment available from supplier auction or direct purchase from a previous owner may be an alternative to purchasing new equipments. Purchases of used equipment, in fact, constitute an important percentage of total machinery sales. Used equipments are available for a number of legitimate reasons.

a) When a firm buys a new machine, it frequently disposes of its old ones.

b) A firm that extensively modifies its product design or its total production process is in a better to position to obtain more specialised production equipment and hence put up the old ones for sale.

c) Some use equipments equally becomes available because the owner lost a particular contract or has discontinued operation altogether.

3.3.1 Used Equipment Sources

Lamer Lee Jr. et al (1981) listed four sources from which used equipment is available and commonly purchased:

(i) Used Equipment Dealers

Used equipment dealers sell two types of machine viz, reconditioned machines and rebuilt machines. Generally speaking, a reconditioned machine carries a dealer's guarantee and sells for about half or less of the price of a similar new machine. A rebuilt machine typically carries a more inclusive dealer warranty and sells for perhaps half for even more than a new machine's price.

(ii) Directly from the Owner

Some owners prefer to sell their used equipment directly to the next user because they feel they can realise a higher price than by selling to a dealer. Some buyers also prefer this arrangement. It permits them to see the machine in operation and learn something about its usage history before making the purchasing decision.

(iii) Brokers Occasionally, an industrial supply house or a manufacturer's agent will act as a broker for a good customer by helping him dispose of an old piece of equipment which has a limited sales market.

(iv) Auction Auction represents still another source of used equipment. When a commodity is sold by auction, prospective buyers make bids. It is commonly being sold to the person making the highest bid. Generally speaking, buying at auction is somewhat more risky than the other supply sources because:

a) Auction machine usually carries no warranty, and so there can be no return after sales.

b) It is rarely possible to have the machine demonstrated

c) Buyer's lack of perfect knowledge about the goods bided for.

d) Absence of after sales services. It is therefore advisable that industrial buyers must have a spending limit and should avoid always buying at auction because of its inherent risks or shortcomings. Two types of auction are common. These are open and closed auction.

3.3.2 Reasons for Purchasing Used Equipment

A purchaser may have several reasons for deciding to buy used equipment. Some of the important reasons include:

(1) The cost of used machinery is substantially less than that of new equipment.

(2) Used equipment is frequently more quickly available than new equipment. In some situations, availability may override all other consideration.

(3) Used equipment, especially when reconditioned and rebuilt, may have a long life and be protected by warrants.

(4) Another common reason for the purchase of used equipment is that used equipment adequately satisfies the purchaser's needs, in which case there is no point in buying new equipment.

3.3.3 Cautions in Purchasing Used Equipment

The age-old adage of caveat emptor – let the buyer beware – is particularly applicable when purchasing used equipment. Though, protection is given by the sales of goods, misrepresentation and Trade descriptions Acts; the buyer of used equipment should work on the principle of Caveat emptor.

As a procedural guide, the buyer of used equipment should be able to ask some of the following questions:

1) Is the usage history of the equipment available?

2) Are component and parts readily available? Will they continue to be?

3) Is there any indications of the equipment age such as serial number?

4) How well has the equipment been maintained over the usage period?

5) What will be the cost, where appropriate, of dismantling, transporting and re-erecting or installing equipment?

6) How does the price asked for used equipment compare with the cost of buying new one?

7) Does any warranties supersede the protection given under the Sale of goods Act?

8) What trials, test or approval period will the vendor allow?

9) What special term conditions, if any apply to the purchase?

The above questions are by no means exhaustive. A purchaser of used equipment may ask more questions than the aforementioned ones. This depends on the personal intelligence endowed to the buyer. Generally speaking, it is difficult to determine the true condition of a used machine and to estimate the type and length of service it will provide. For this reason, it is:

1) Wise to have one buyer specialise in used equipment.

2) Moreover, it is virtually essential to enlist the cooperation of an appraising used equipment.

3) In preparing a purchase order for used capital equipment, care must be taken to include all essential data.

4.0 CONCLUSION

There is no gainsaying that purchasing has been an important aspect of management, be it business management or management of non-profit. In contemporary business operation, how well an organisation does its buying may spell the difference between profit and loss. Indeed, there is an old proverb, Goods well bought are sold. This is literally true in the purchasing function of a manufacturer, purchasing raw materials and equipment or in the purchasing function of merchant middlemen whether wholesalers or retailers. Even in the modern consumer market, particularly, for sophisticated goods, e.g. specialty goods, the purchasing function is very important; purchasing however has a wider meaning. It is more than mere buying. It is considered a managerial activity and it includes planning, organisation and control of a wide range of interrelated activities. Purchasing is very closely related to production as well as marketing departments of an organisation. All these three functional areas of business must work in cooperation to fulfill the company-wide targets.

5.0 SUMMARY

Modern advanced industrial technology rests upon the use of vast amounts of capital: elaborate machinery, large-scale factories and plants, stores and stocks of finished and unfinished materials. Capitalism got its name because this capital or productive wealth is primarily the private property of somebody – the capitalist. There is no single market for industrial goods, but several markets. Industrial buyers tend to base their selection of goods and services on objective criteria. The industrial buyer buys a vast variety of goods and services. Some goods and services are relative expensive and are generally used within a year of purchase. Those that are more expensive and have a longer useful life are considered capital items. Every purchased transaction originates with the recognition of the need for an item by someone in the enterprise. This need may originate in the department using the material.

6.0 TUTOR-MARKED ASSIGNMENT

What factors would you advise you advise your company to consider in the purchase of capital goods?

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UNIT 9 PURCHASING PRACTICE AND METHODS – (II)---------------92

Content

1.0 INTRODUCTIION

The specific form of material organisation most appropriate for one company may not be the best form for another company, a brief discussion of two materials activities will illustrate why the unique nature of a specific firm's ;operating activities influences its form of material organisation so heavily. Assume that a plant purchases all the parts, components and subassemblies for the product it manufactures. In this situation, if production were uniform, the production planning schedule and the purchasing schedule would be similar or identical. Consequently, for this firm to achieve optimal materials and cost control production control should realistically be included in the materials management department. Assume now that a plant manufactures all the parts, components, and subassemblies that are used in turning out its product. In this situation, there may be very little similarity between the production planning and purchasing schedules. Therefore, in this firm, a strong case could be made for locating production control within the production department.

2.0 OBJECTIVE

At the end of studying this unit, you should be able to:

5) Define leasing as an option regarding equipment acquisition
6) Explain the technicalities of buying for resale
7) Discuss the increasing importance of subcontracting in the purchase of services
8) Outline and explain the issues involved in the purchase of services

3 .0 PROCUREMENT PRACTICE AND METHODS CONTENTS - II

3.1 LEASING

The purchasing manager may be involved in deciding upon the most appropriate method of acquiring a set of equipments or replacement of equipments for the organisation. The method selected will be affected by the following major consideration; The three options regarding equipment acquisition are: (i) Leasing (ii) Hiring (iii) Outright purchase. Product leasing is not a new way of doing business. Leasing is a means whereby a firm may acquire the use of equipment without the necessity of taking title. As a concept, a lease has been defined by the Equipment Leasing Association as: *"A contract between lessor and lessee for the hire of a specific asset selected from a manufacturer or vendor of such assets by the lessee."*
The lessor retains ownership of the asset. The lessee has possession and use of the asset on payment of specified rentals over a period.

The agreement with the owner to use the property is a lease. The owner is the lessor and the person taking possession is the lessee. The equipment remains the property of the lessor but responsibility for its maintenance is the duty of the lessee. Under the status for Frauds, a lease for longer than a year must be put in writing to be enforceable. The more formal written lease usually contains the following:

1) Date of agreement
2) Names of lessor and lessee
3) Property description
4) Duration of lease
5) Manner of paying rent
6) Responsibility for making repairs
7) Liability for injury to third party

8) Right to sublet or resign

3.1.1 Types of Leasing Arrangement

Lease agreements have become popular methods for financing both small and large enterprises, and it is carried on under a number of types of arrangement. The following are almost certainly the most common.

1) By Maker to User

The manufacturers of equipments such as data processing equipment usually lease directly to users as a means of marketing their products, which are often highly specialised and technical.

2) By One User to another User

3) By Leasing Company to a User

The arrangement of leasing by one user to another user is somewhat cumbersome and depends on cooperation between firms that often compete with one another. The result has been the emergence of firm that buys machines from the equipment makers and leases them to users.

4) By a Finance House to User

In this type of leasing agreement, the lessor has no commercial interest in the transaction other than as a supplier of finance. The lessor pays for the asset and thereby become its owner.

3.1.2 Advantages of Leasing

There are several advantages to the leasing method and it is an increasingly popular option.

(a) No capital commitment: The organisation will not have to find large sums of money to acquire the equipment.

(b) Low cost: The leasing method of acquiring equipment is the lowest of the three options (i.e. leasing, hiring and outright purchase), and this is an advantage.

(c) Leasing enables the suitability of equipment to be assessed over a predetermined trial period. **(d) Leasing provides an edge against the risk of obsolescence.**

(e) Replacement decisions are made easier.

3.1.3 Disadvantages of Leasing

(a) The lessee has to maintain the equipment: This can be very expensive

(b) Fixed term contract: The equipment cannot be returned to the lessor in the event of change in the lessee's business needs.

(c) Leasing does not provide the prestige of ownership.

(d) Resale value: In time of inflation, ownership is generally at an advantage because the resale value rises with inflation.

3.2 Buying for Resale

Buying goods (or merchandise) for resale has much in common with other kinds or purchase; even though purchasing for resale is one vital aspect where the business function of marketing and procurement considerably overlap. Sometimes described as speculative buying, buying for resale is a process that involves reselling the merchandise bought, in most instances, without anything being done or any value being added to the purchased item. Buying for resale is the glamour job in retailing. It is an activity, which owes more to marketing than purchasing. What retailers, wholesalers or other members to the distributive sector but they also sell.

Important Consideration

Generally speaking, the decision as to what to buy must frequently be taken with a strong feeling for what to sell. This is because, decision in the buying for resale practice has to be made in terms of what to buy, quantities, prices, delivery terms, and mode and timing of payment. In deciding what to buy, the first major task is to apply marketing research. In specific term, marketing research has been defined as: “the systematic gathering, recording and analysing of data about problems in marketing goods and services”. This major activity will help satisfy the resale buyer’s unending need for information about the market, sources of supply, the goods etc. All retailers need to plan what goods to sell for. In most cases, what a business sells is what that business is. The terms merchandising and buying are used interchangeably. And in developing a range of merchandise (i.e. the product mix; a group of related products) a resale buyer should consider such questions as: (a) Is this product suitable for our store image? (b) Is it appropriate for our target markets? (c) What is the likely demand for the product?
(d) How readily is the product group available?
(e) On what terms could we buy it?

3.3 Future Dealing

According to Lyson (2000:335), a commodity such as copper may be bought directly from the producer or on a commodity market. The latter (i.e. the commodity market) provides the advantages of futures dealing. The London markets for example are divided into two main areas: metals and soft commodities. The non-ferrous metal markets in copper, tin, zinc, and silver operates at the London Metal Exchange

(LME). The soft commodity markets dealing in cocoa, coffee, sugar, vegetable oils, wool and rubber are situated at the Corn Exchange building.

The Functions of Exchanges

(1) To enable customers, merchants and dealers to obtain supplies readily and at the competitive marketing price.

(2) To smoothen our price fluctuation due to change in demand and supply

(3) To provide insurance against price fluctuation through the procedure known as ‘hedging’

3.3.1 The Purpose of and Conditions for Future Dealing

The purpose of future dealing is to reduce uncertainty arising from price fluctuation due to supply and demand changes. This reduction in uncertainty benefits both producers and consumers. The producer can sell forward at a sure price; the consumer can buy forward and fix materials cost in accordance with a predetermined price. Manufacturers of copper wire, for example, might be able to obtain an order based on the current price of copper. If they think the price of copper may arise before they can obtain their raw materials they can immediately cover their copper requirements by buying on the LME at the current price for delivery three months ahead, thus avoiding any risk of an increase in price.

For future dealing to be undertaken the following conditions must apply:

(1) The commodity must be capable of being stored without deterioration for a reasonable period.

(2) The commodity must be capable of being graded for the purpose of providing a basis for description in the contract

(3) The commodity must be tradable in its raw or semi-raw state

(4) Producers and consumer must approve the concept of futures dealing

(5) There must be a free market in the commodity, with many buyers and sellers, making it impossible for few traders to control the market and thus prevent perfect competition.

3.3.2 Some Terms Used in Futures Contracts 1) Arbitrage The (usual) simultaneous purchase of future in one market against the sale of future in a different market to profit from a difference in price.

2) Backwardation The backwardation situation exists when forward price are less current ‘spot’ ones.

3) Contango A contango situation exists when forward prices are greater than current ‘spot’ ones.

4) Force Majeure The clause which absolves the seller or buyer from the contract due to events beyond his or her control, e.g. unavoidable export delays in producing countries due to strikes at the supplier’s plant. Note.

5) Futures Contracts for the purchase and sale of commodities for delivery some time in the future in an organised exchange and subject to all the terms and condition included in the rules of that exchange.

6) Hedging Hedging is the use of future contract to insure against losses due to the effect of price fluctuations on the value of stocks of a commodity either held or to be acquired. Basically this is done by establishing a position in the futures markets opposite to one's position in the physical commodity.

3.4 Sub-Contracting

Organisations of all kinds subcontract aspects of their activity, and subcontracting is often viewed as a means of augmenting limited resources and skills while still enabling the contractor to concentrate on his or her main area of expertise in the execution of prime contract. When a contract has been awarded to a supplier (the prime contractor), the supplier frequently subcontracts some of the production work required to the job. Items purchased on subcontracts are actually purchased parts or components. However, subcontracting usually takes place when it is not possible to produce the parts in the local plant by the prime contractor. Hence subcontracting is: the work of obtaining the prime contract's (manufacturer's) requirement, mostly of fabricating parts and components, from outside sources in order to manufacturer a certain product (or execute an awarded contract) in the prime contractor's plan.

A large firm may like to concentrate its efforts on major items of the contract and leave several minor ones to small manufacturer. Thus many types of organisation subcontract security arrangement, waste or scrap disposal, plumbing and a whole range of specialist activities provided they are considered more conventional sub-contract services. The subcontractors are thus legally responsible to the prime contractor rather than the buyer or client even when the client has stipulated which subcontractors is to be used. The prime contractor's subcontracting decisions are however important to a buyer because they may involve a large percentage of prime contract money. Sub-contract price and performance influence the prices the buyer pays the prime contractor.

3.4.1 Reasons why Subcontracting has become a Major Management Activity

Three reasons have been responsible for the prominent rise of subcontracting as a major activity requiring management decision on part of both the prime contractor and the sub-contractor. These are:

(a) The rapid rate of technological inventions.

(b) The fast rate of installation of this change in products and processes.

(d) Further movement toward specialisation, which is characterising business enterprises throughout the world.

For the above reasons and others as listed Peter Bailey and David Farmer (1981:254), subcontracting is a major management activity.

(1) One major reason is insufficient financial resources to provide facilities to perform the function within the company.

(2) Lack of (production) capacity internally.

(3) Lack of time for completion of work to meet a rapidly approaching “target date”. (4) Lack of know-how because of complexities of rules and procedures to make the item in-house.

(5) Because a specialist sub-contract is more cost effective either in production or geographical location terms.

(6) Customer or buyer stipulates that work should be sub-contract, usually for a nominated firm.

3.4.2 Selecting a Sub-Contractor

Although, all issues relating to sourcing (as discussed in unit five) are relevant in the selection of a subcontractor, certain pertinent and additional issues require further detail consideration in the selection of a subcontractor. Bailey and Farmer (181) suggested a number of key questions to be asked and answered in subcontractor selection.

1) What is the company’s major specialisation? For example, are they jobbing machinists, or are they capable of working to close tolerance? For whom have they worked? How long have they worked for these companies? Can we ask these customers about their service and quality performance record?

2) They do have a permanent and well-trained labour force? What is their industrial relations record?

3) Are their quality – control procedures adequate?

4) Are their production –control procedures adequate?

5) Are they adequately financed?

6) If tooling is required, can they make the tools themselves?

7) Do they own their own transport? Is it reliable?

8) In government work, are they approved by the relevant inspectorate?

Where possible, each of these questions can be expressed in quantitative terms. Notwithstanding, the extent to such investigations depends upon the quality and importance of the work to be undertaken. To however do an effective buying job, the following necessary actions are to be taken:

(a) Continuous appraisal of subcontractors because of changes that inevitably take place in companies over time.
(b) Specification and standardisation of working should be agreed before subcontractors submit quotations particularly with new subcontractors.
(c) In higher subcontracting, close liaison between the prime contractors and the sub-contractor's staff essential.

3.4.3 The Rules of Behaviours in Subcontracting

It is a truism that two cannot walk unless they agree. This also found expression in subcontracting. Until the two organisations involved know each other well and technical requirements are fully understood, the maxim, **if in doubt –ask!** Should be adopted. It is therefore further suggested. By Peter Bailey and David Farmer that it is a good practice to:
(1) Make an individual particularly responsible for all contracts with sub-contractors.
(2) From the outset, work requirements of the sub-contractor must be clearly established.
(3) From the outset, understanding must be reached as to the quality and workmanship, which is required of the sub-contractor.
(4) Make provision for compensation for any spoilage or partially finished work by the subcontractor subject to accepted conditions of trade.
(5) It is often advantageous to supply the sub-contractor with tooling and equipment on loan, particularly if the subcontracting arrangement is temporary.
(6) Inspection arrangement needs to be clearly
(7) Procedure and documentation should also be clearly b established at the outset.
(8) The limit of the sub-contractors liability for damage to persons or property in respect of claims arising from the contract should be clearly defined.

3.5 Purchasing Service

The procurement of service is one of the purchasing most interesting and challenging assignment because large sums of money are involved. Expenditure on service in all types of organisation (e.g. profit or non-profit making organisations, government or non-governmental organisation etc) increases each year. The reasons for this are the key roles played by purchased services in the successful operation of these organisations. In many instances, the impact of the services themselves on the success of the organisation's operation is far greater than the impact of the naira spent. Service ranging from architectural engineering, promotion and advertising, and development of software, to the maintenance and repair of production equipment are of critical importance to the operations of the organisation. More mundane purchase such as cafeteria and janitorial operations impact the morale of all employees. Services which are not at all in the areas of competence of an organisation such as management information system, payroll travel services, delivery service, even the procurement of MRO supplies and service, are being outsourced to service providers. These suppliers have the expertise and economies of scale to allow them to provide the service at the same or higher quality level than the purchasing firm and at a lower total cost.

3.5.1 Selection of Service Contracts

Selecting the "right" source is much more of an art when purchasing services than when purchasing materials.

• Based on the complexity of such services procurement and the unexpected problems that tend to rise, it is normally prudent practice to select only established, reputable firms.

• When a large number of potential contractors are available, the buyer and the customer normally reduce this list to three to five firms.

• The buyer then invites proposal from only the potential suppliers with which the buying firm would be comfortable doing business. During the evaluation process, emphasis should be placed on the total cost and total benefits to the buying organisation.

• In addition to the traditional concerns about a prospective contractor's financial strength, management capability, experience, and reputation, the area of technical capabilities requires special analysis.

3.5.1.(a) The Ideal Services Supplier

The ideal service supplier listens to what users complain about most and then design service products that supply the market's missing ingredients. Satisfaction is built into service products rather than added as an afterthought. The ideal services supplier invests to increase both employee productivity and customer satisfaction. If such an "ideal" services supplier or contractors is not available, the purchasing firm should consider the development of a long-term relationship with a supplier willing and able to grow into an "ideal" provider.

3.5.1.(b) Professional Services

Architect, engineering firms, lawyers, consultants, and educational specialist are representative of the individuals and firms which provide professional service. The professional buyer pays particular attention to the relationship between the price mechanism (e.g. firm fixed price, cost plus incentive fee, fixed price with award fee, and so on) and the contractor's motivation on critical professional services contracts. Every naira that the supplier's costs are reduced results in a naira of additional profit Administratively, it may be impractical to use anything other than a fixed price contract or an hourly rate price for relatively small professional services contracts. Even on larger naira amounts, the supplier's reputation may allow the use of a fixed price contract. But buyers should be aware of the potential effect of the pricing mechanism on the contractor's performance.

3.8.1(c) Operating Services Janitorial, security landscaping, and cafeteria operations are operating services. Experience has shown that obtaining effective performance of such can be very challenging for administrators. Accordingly, the compensation scheme should reward the supplier for good and penalize it for poor service. Such an approach to pricing greatly aids in the administration of the contract and results in a higher level of customer satisfaction.

Insurance, plant and equipment maintenance, and anticipated emergency service should be priced through the use of competition of carefully prequalified supplier. Unanticipated emergency repairs normally are purchased on a "not- to exceed" time and materials basis.

4.0 CONCLISION

There is no gainsaying that purchasing has been an important aspect of management, be it business management or management of non-profit. In contemporary business operation, how well an organisation does its buying may spell the difference between profit and loss. Indeed, there is an old proverb, Goods well bought are sold. This is literally true in the purchasing function of a manufacturer, purchasing raw materials and equipment or in the purchasing function of merchant middlemen whether wholesalers or retailers. Even in the modern consumer market, particularly, for sophisticated goods, e.g. specialty goods, the purchasing function is very important; purchasing however has a wider meaning. It is more than mere buying. It is considered a managerial activity and it includes planning, organisation and control of a wide range of interrelated activities. Purchasing is very closely related to production as well as marketing departments of an organisation. All these three functional areas of business must work in cooperation to fulfill the company-wide targets.

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Modern advanced industrial technology rests upon the use of vast amounts of capital: elaborate machinery, large-scale factories and plants, stores and stocks of finished and unfinished materials. Capitalism got its name because this capital or productive wealth is primarily the private property of somebody – the capitalist. There is no single market for industrial goods, but several markets. Industrial buyers tend to base their selection of goods and services on objective criteria. The industrial buyer buys a vast variety of goods and services. Some goods and services are relative expensive and are generally used within a year of purchase. Those that are more expensive and have a longer useful life are considered capital items. Every purchased transaction originates with the recognition of the need for an item by someone in the enterprise. This need may originate in the department using the material.

6.0 TUTOR-MARKED ASSIGNMENT

What sense does the rules of behaviours in subcontracting make to you? Explain these rules.

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UNIT 10 MANAGEMENT OF INVENTORY 103

Contents

1.0 INTRODUCTION

One of the major tasks of any management today is to control stock or inventory (These two terms-inventory and stock – shall be used interchangeably for the purpose of this book as the terms are definitionally indistinct). Both goods producing and service providing companies use materials. In majority of industries, inventories constitute the most significant part of current assets. Indeed, for many manufacturing firms materials costs account for over 50 percent of total production costs. To neglect effective and efficient management and control of inventories is to jeopardize a business Lon run profitability and survival (Ishola, T. O; 2002, P. 263). Stocks are defined by the Chartered Institute of Management Accountants as; Goods or inventory held comprising:

• Goods or other assets purchased for resale;
• Consumable stores;
• Raw materials and components purchased for resale incorporation into products for resale;
• Products and services in intermediate stage of completion (work-in-progress);
• Long-term contract balances; and
• Finished goods.

Similarly, inventory is an American accounting term for the value or quantity of raw materials, components, assemblies, consumables, work-in-progress and finished stock that are kept or stored for use as the need arises.

The term also applies to; (1) A detailed list of goods or articles in a given place or (2) A stocktaking. Thus in an organisation, Inventory refers to the storage in storehouse or warehouse of products manufactured for sale and components that make up the product. Inventory relates to only materials or goods; services are excluded. Inventory (or stock) control in this context therefore, refers to 'the techniques used to ensure that stocks of raw materials or other supplies, work-in-progress and finished goods are kept at minimum levels of cost'.

2.0 OBJECTIVES

At the end of this studying unit, you should be able to:

• highlight various classifications of inventory and the reasons for holding inventory
• explain the economic principles behind stock control
• state and describe different approaches to stock control

• comment on the problem associated with the EOQ model.

3.0 MAIN CONTENT

3.1 Inventory Classifications

Much as the various functions of stores management has been identified with the receipt, preservation different types of inventories or stocks or materials maintained in a business organization can also be identified. All businesses use the same general classification of inventories, including raw materials, purchased parts, work-in-progress, finished good and supplies.

1) Raw Material

A raw material inventory includes all items that being received at the plant require additional processing before becoming an identifiable part of the finished product.

2) Purchased Parts

This classification of inventory is applied to component parts of a product that need no additional processing before being assembled into the finished product.

3) Work-in-Progress

This classification of inventory is self-explanatory. All material that leaves either raw materials store or purchased parts stores enter the work-in-process inventory until the product is completed and placed in finished goods.

4) Finished Goods

Again, this is self-explanatory – it is the stock of finished or completely manufactured goods/products which are ready for sale. Generally speaking, this classification applies to the quantities of finished goods that are held at the factory awaiting shipment.

5) Supplies

All the materials needed for the operation of the firm that are not used as parts of the finished product are classified as supplies. Cost accounting commonly identifies this stock classification as ‘indirect material’. On the other hand, the material that becomes parts of the finished product is called ‘direct material’.

3.2 Reasons for Holding Inventory

The question of managing and controlling inventories or stocks arise only when the company holds inventories. Maintaining stocks arises only when the company holds inventories. Maintaining inventories involves typing up of the company's funds. Unintentional excess buying and overstocking inevitably result in unprofitable investment, high inventory holding or carry charge (e.g, storage and deterioration expensive) and possible losses caused by price declines. If it is so expensive to maintain inventories, why do companies then hold stocks? There are three general motives for holding inventories or stocks. These are: 1) The transaction motive which emphasizes the need to maintain inventories to facilitate smooth production and sales operation on basis.

2) The precautionary motive explains the need for inventories to guard against the risk of unpredictable changes in demand and supply forces and other factors 3) The speculative motive influences a firm's decision to increase or reduce stock levels to take advantage of price fluctuations. In more specific terms, the following additional reasons have been severally advanced as reasons for holding inventory: (a) To avoid the loss of customers that occurs when product is not stocked. (b) To meet sudden spur in customer demand (c) To keep the firm from cutting back or shutting down briefly due to material shortages, depletion or exhaustion.
(d) To capitalize on discount in the price of raw materials.
(e) To protect against strikes
(f) To manufacture product in quantities that minimize cost.

3.3 The Objectives of Stock Control

Objectives are the desired end-results. The ultimate objective of all manufacturing controls is to realise a profit through the operation of the business. A more restricted objective of the control of materials is to satisfy the customer by meeting the schedule for deliveries. Failure to deliver customers' orders on time is one principal cause for the loss of business and customers. Effective control of materials throughout the manufacturing cycle prevents this problem from arising.
The following additional objectives or aims of inventory control are classical to mention:
(1) To provide both internal and external customers with the required service levels in terms of quantity and order rate fill.

(2) To ascertain present and future requirements for all types of inventory to avoid overstocking while avoiding bottlenecks in production.

(3) To keep costs to a minimum by variety reduction.

(4) To improve the quality of manufactured goods by the use of better raw materials or components.

(5) To ensure co-operation among all departments of the enterprise to meet materials management objectives.

3.4 The Economics of Stock Control

Inventory or stock constitutes an investment, which must be controlled. Firms are however commonly faced with the problem of meeting conflicting needs in the context of inventory management. These are:

(1) To maintain a large size of inventory for efficient and smooth production and sales operations.

(2) To main a minimum investment in stocks to maximise profitability. Business firms should always avoid over-investment or under-investment in stocks or inventories. There are basic costs incurred by any organisation, which holds stocks. The economics to stock management and control can therefore be determined by an analysis of the costs incurred in obtaining or acquiring and carrying inventories. Lyson, k (2000:222) presented the procedures for such costs analysis under the following headings:

3.4.1 Acquisition Costs

Many of the costs incurred in placing an order are incurred irrespective of the order size, e.g. the cost of an order will be the same irrespective of whether 1 or 1000 tons are ordered. Ordering costs including: (1) Preliminary costs, e.g. preparing the requisition, vendor selection, and negotiation. (2) Placement costs, e.g. order preparation, stationery, postage, etc. (3) Post-placement costs e.g. progressing, receipt of goods.

3.4.2 Holding Costs

These costs relate primarily to the consequences of over-investment in inventories or excessive stocks, and these are of two types:

(A) Costs proportional to the Value of Inventory, e.g. (1) Financial costs, e.g. interest on capital tied up in stock or inventory. This may be bank rate or, more realistically, the target return on capital required by the enterprise. (2) Costs of insurance (3) Losses in value through deterioration, obsolescence and pilferage.

(B) Costs Proportional to the Physical Characteristic of Inventory. These include: (1) Storage costs, e.g. storage space, stores rate, light, heat and power. (2) Labour costs relating to handling and inspection. (3) Clerical costs relating to stores records and documentation.

The total costs per annum under each heading will be expressed as a percentage of the monetary value or quantity of the average stock held.

3.4.3 Costs of Stock Outs

These are costs incurred for under-investment in inventory resulting in inadequate stocks of materials. These comprise: 1) Loss of production output. 2) Costs of idle time and of fixed overheads spread over a reduced output. 3) Costs of action taken to deal with the stock out, e.g panicky buying at an uneconomical price for lack of time for proper negotiation, switching production, obtaining substitute materials. 4) Loss of customer goodwill through the inability to supply or late delivery. 5) Opportunity cost like forgone quantity discount. Often costs of stock outs are hidden in overhead costs. Costs of stock outs are difficult to estimate or incorporate into inventory models.

3.5 Approaches to Stock Control

As previously noted in the sub-section 3.3 discussion, the objective of inventory or stock control should be the avoidance of excessive and inadequate levels of inventories and the maintenance of sufficient stock to ensure operational smoothness. Although there are many systems for the control of stock, both manual and automatic, there are really only two basic approaches on which these stock control systems are based. Re-ordering of supplies will either take place: (1) When stocks fall to a predetermined level, or (2) According to the situation discovered when physical stock levels are reviewed on a periodic regular basis. Sometimes, these approaches will be used in combination. For example, it might be the case that the reorder level approach is employed with the backup of periodic regular review of physical stock levels. The two approaches are commonly called the “action level” method and the “period review” approach. Emphasis shall however be on the former for the purpose of this book.

3.5.1 The Action Level Method

The basic method of controlling stock by quantity is by means of fixed, for each commodity, stock levels that are recorded in the stock control system (usually the perpetual inventory record) and subsequently used as a means of indicating when some action is necessary. There are various kinds of stock levels, but the fundamental controls are;

1) Maximum

2) Minimum

3) Re-order

4) Hastening

5) The Economic Order Quantity (EOQ)

It does not follow that all these are necessary or even desirable for every material items, and they should be employed with discretion, because the fixing of too many levels make the work of provisioning unduly complicated.

1) The Maximum Stock Level

This is the level calculated representing the maximum stock that should be held in store in order to minimise the costs of over-stocking.

Only under abnormal circumstances should management authorize purchases above this uppermost limit.

In determining the maximum stock level, consideration is given to a number of factors like;

1) The rate of materials consumption,

2) Availability of storage space,

3) Risk of deterioration, obsolescence, and / or evaporation,

4) Economic conditions like price stability and availability of materials from suppliers.

There is no general consensus about the method for calculating this stock level but it may be expressed as:

Maximum stock = Recorder level +Recorder quantity = Minimum usage during reorder period.

2) The Minimum Stock Level

This is the lowest level below which stock should not be normally allowed to fall if the firm is not to risk the consequence of inadequate inventory or stock outs. It is the minimum reserve or buffer stock, which comes in handy during emergencies.

The factors affecting the minimum stock level include:

1) The rate of consumption

2) The lead or re-procurement time.

The lead-time is the period of time between placing order or raising requisition (internally or externally) and materials delivery i.e. when goods are made available for use.

It is expressed as a mathematical formula as follows:

Minimum Level = Demand x delivery period

(100 per week) x (6 weeks) = (600)

Min Level = 600.

3) Re-order Level

This is point at which it is essential to initiate purchase requisition. It is a point in betweens the maximum and minimum stock levels. It is the quantity of stock necessary to protect against the exhaustion of the stock during the gap between the date of order and the date of delivery. When the level of stocks or the balance on hand reaches this level, it is an indication that a new order must be placed at once.

The reorder level is affected by factors like: 1) Material consumption rate 2) Minimum level

6) Lead time and risk factors like variations due to uncertainty.

As a formula, it is expressed as follows: Reorder Level = Minimum stock + 25 per cent buffer stock.

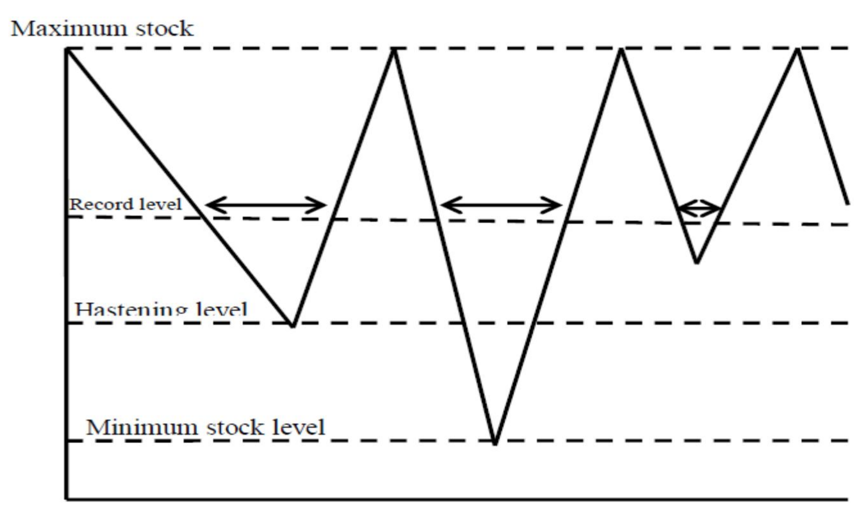
Because of the risk involved in telling on prompt deliveries, a figure for extra or buffer stock (often 25 per cent of minimum stock) is added to the minimum stock. Applying the above formula therefore, we have;

Minimum stock = (600) + 25 per cent buffer stock

= (600) + (150) = (750) ► Reorder level = 750.

4) The Hastening Stock Level

This is the amount expressed in units of issue at which it is estimated that hastening action is necessary to request suppliers to make early delivery. It is fixed between the minimum and the reorder stock levels. These stock levels are graphically illustrated in figure 9.1 below.



Time (days/weeks/months

$\longleftrightarrow$ = Lead time Constant ordering quality

Figure 4.1: An action level approach to stock control

The point that must be stressed is that, in order to keep abreast of changing market (environmental) conditions, after stock levels have been established in the first instance, they should be carefully reviewed at suitable intervals e.g. quarterly, monthly, or even weekly, and adjusted to meet changes in the prevailing circumstance. Unless this is done, the levels originally fixed soon become out-dated and system of stock control is rendered ineffective.

3.5.2 Inventory (Stock) Control Models

As a concept, a model is a simplified representation of reality. It is a pattern for solving problems and consists of set of interrelated variables that represent some realities (either of a system, process, or outcome) as closely as possible. A model is used to answer such questions as what if, and which is best? Given this conceptual framework, therefore, Inventory control model deals primarily with the problems of “how often” to order more raw materials and “how much” to order, “How many” goods to produce during a period to keep the finished goods inventory at the right level.

BUT WHAT LEVELS ARE RIGHT?

Among the most useful techniques for determining how much to order is the economic order quantity (EOQ); that is the level that balances two different kinds of inventory costs-holding (or carrying) costs and ordering (or acquisition) costs. The EOQ is simply the stock level that mimeses the total of ordering and carrying costs (please refer to the 9.4.1 and 9.4.2 for the detailed discussions of these two costs.)
An easy way to determine EOQ is to use the order formula approach even though it can also be found out graphically. Hence, the EOQ of an item can be expressed in more detailed terms using the formula below:

$$EOQ = \sqrt{\frac{2DC}{CI}}$$

Where: D => Demand or annual usage

O => Ordering cost or acquisition cost

C => Carrying cost or holding cost

To be able to calculate a basic EOQ, certain assumptions are necessary. These includes:

i) That there is a known constant stock-carrying cost.

ii) That there is a known, constant ordering cost.

iii) That the rates of demand are known.

iv) That there is a known, stable price unit

v) That the whole ordered batch is delivered at once without any limitation imposed by stores capacity.

The EOQ formula can be derived or obtained using differential calculus as illustrated in the following section.

1) ORDERING COSTS

The number of orders placed each year is:

$$\text{Annual Usage in units} \qquad = \frac{a}{q}$$

Order quantity

The ordering costs are costs of placing an order x number of orders =

$$c \text{ x } \frac{a}{q} = \frac{ac}{q}$$

2) HOLDING COSTS

$$\text{The average stock level is half the order quantity} = \frac{q}{2}$$

The holding costs are average stock level x holding

$$\frac{q}{2} \text{xh} = \frac{hq}{2}$$

(3) TOTAL COST Total cost =holding costs + ordering costs

$$\overline{T} = \frac{Hq}{2} + \frac{ac}{q}$$

(4) MINIMUM COST T will be maximized or minimized when

$$\frac{dT}{dq} \qquad = O$$

$$\frac{dT}{dq} \qquad = \frac{h}{2} - \frac{ac}{q^2}$$

$$\frac{dT}{dT} \qquad = O = \frac{h}{2} - \frac{ac}{q^2} = O \quad hq^2$$

$$\text{On cross multiplying} \quad = \quad q^2 \qquad \frac{2\,ac}{h} =$$

$$= q2. \quad = \frac{2\,ac}{h}$$

NOTE: (Since q cannot be negative only the positive square root is used.) Thus the total cost is a minimum when:

$$\textbf{EOQ} = q = \sqrt{\frac{2\,ac}{h}}$$

The formula may be clarified by means of a simple illustration, in which the following facts are assumed:

q. = Order quantity in unit

a. = Annual usage in unit

c. = Acquisition cost per order

p. = Price per unit h. = Holding cost per unit Note: h is the actual cost of holding one unit for one year. In examination questions, the holding cost is sometimes given as a percentage of the price of a unit.

EXAMPLE 1

If the holding cost is 5% and the price of a unit is N 140.oo then

$$h. \quad = \quad \frac{₦140}{100} \times 5 \text{ ₦ } 7.00$$

EXAMPLE 2 To check that the formula works let's apply it to this problem in which a= 8,000; c = 25, h = 2.50. Hence:

$$\text{EOQ} = q = \sqrt{\frac{2\,ac}{h}}$$

$$= \sqrt{\frac{2. \times 25 \times 8000}{2.50}}$$

$$= \sqrt{\frac{400{,}000}{2.50}} = 160{,}000$$

EOQ => 400 Units.

EXAMPLE 3 A manufacturing company has an expected usage of N50,000 units of certain product during the next year. The cost of processing an order is N20 and the carrying cost per unit is N 0.50 for one year.

Lead-time on an order is five days and the company will keep a re-service supply of two days usage.

You are required to calculate: (a) The economic order quantity, and

(b) The re-order point (Assume 250 – day year)

SOLUTION

(a) The economic order quantity is

$$\textbf{EOQ} = q = \sqrt{\frac{2\,ac}{h}}$$

$$= \sqrt{\frac{2x20x50{,}000}{0.5}}$$

$$= \sqrt{4{,}000{,}000}$$

$$q. = 2{,}000 \text{ units}$$

(b) The re-order point is

Daily usage = 50,000 / 250 = 200 units

Re-order point = Safety stock + lead time X Usage

= 2(200) + 5 (200)

= 400 + 1,000

= 1,400

3.5.3 Problems Associated With EOQ Based System

There are a number of problems that the inventory (or stock) controller must bear in mind when employing the EOQ method of stock control. These are as follows:

(a) Accurately establishing the true cost of ordering and setting a standard to cover every type of order.

(b) Establishing true storage costs, given that many organisations have a very wide range of stock, each requiring different forms of handling and storage

(c) How to cope with unexpected alteration in the pattern of demand for stock.

(d) How to cope with variations in lead-time, even though deliveries may be set at regular intervals, delays can still occur.

SELF ASSESSMENT EXERCISE

Select a manufacturing company and list out the various forms stocks are held.

4.0 CONCLUSION

Both excessive and inadequate stocks are not desirable. In the past, managers of manufacturing concerns assumed that accumulation of adequate stocks were beneficial and therefore do not feel the necessity for controlling.

A number of factors have however helped to change this traditional outlook. Firstly, the modern industrial economy put greater pressure for maintenance of adequate liquidity on firms. Secondly, the wide variety and complexity of requirements of modern industry necessitates a conscious improvement in inventory control.

Today, stock management and controls is a commanding concern in modern business because of the grave implications of poor control over stocks. Business firms should always avoid over-investment or under-investment in stocks or inventories. There are basic costs incurred by any organisation, which holds stocks.

5.0 SUMMARY

Because the stock held by any organisation represents money, the control of that stock has serious financial implications on the company. If the stock is inefficiently controlled, it can cause high storage costs, obsolescence, and a reduction in working capital. Therefore stock control is very much concerned with ensuring that stock is controlled very carefully. In many situations, the actual level of profit earned by an organisation will depend on the success of stock control. Both goods producing and service providing companies use materials. In majority of industries, inventories constitute the most significant part of current assets. Indeed, for many manufacturing firms, materials costs account for over 50 percent of total production costs

6.0 TUTOR-MARKED ASSIGNMENT

How is the economics of stock control determined?

7.0 REFERENCES/FURHER READING

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UNIT 11 NEGOTIATED PROCUREMENTS ----------------------116

Content

1.0 INTRODUCTION

The most flexible, but sometimes complicated, means of procuring goods and services is negotiation. This method is used when contracting offices: 1) cannot define all the requirements of a procurement, or 2) when factors other than price are important enough to require evaluation. Negotiation procurements take many forms. They may call for competitive proposals, may involve restricted competition, or may even be sole source. Some permit discussion with of errors, while others allow award of a contract without discussion

2.0 OBJECTIVES

At the end of this studying this unit, you should be able to:

• define the term Negotiation and clearly states its objectives

• comment on time Negotiation is most appropriate and Highlight the requisite position and qualifications of the Negotiator

• list and Explain the steps involved in the Negotiation process

• identify and describe the various Negotiation Postures.

3.0 MAIN CONTENT

3.1 What is Negotiation?

Regardless of the size of the purchasing department or the volume of purchases, negotiations have to be conducted in every type of industry or business engaged in the function of procurement, whether it is of services or of materials.

It is generally accepted that the ability to negotiate is a key competence in a purchasing executive. In industry, and most levels of government, the term negotiation frequently causes misunderstanding. Depending on the level of perception and/or objective:

(1) some may consider negotiation as a form of **horse-trading** (arguments about something e.g. prices); or hassling and

(2) sometimes, it is confused with **price chiseling** (that is obtaining price deceitfully).

But negotiation is neither haggling nor bargaining. The dictionary defines negotiation as a: "Mutual discussion and arrangement of the term of a transaction or agreement". OR simply; confer with others in order to reach a compromise or agreement" Another expert opinion descried negotiation as, 'The process by which we search for terms to obtain what we want from somebody who wants something from us.'

This particular definition more importantly revealed that negotiation implies some mutuality of wants, resolved by exchange. Purchasing and supply is certainly concerned with exchanging for value, and with finding new ways of doing business. However, defined, negotiation is more usefully seen as a process whereby agreement is sought. Professional negotiation is thus a means by which two parties reach an agreement by a specialised process of communication techniques and arrives at a mutually satisfactory settlement, resulting in a balancing of the interests of the parties. Indeed, the following facts must be established about negotiation in purchasing.

5) Negotiations may involve dealing with a single issue or many
6) They may also be conducted on a one-to-one basis or between teams of negotiators representing different interests, and
7) May be conducted over a telephone in a matter of minutes, or take many months to complete.
8) It can be for the purpose of setting the price of materials or it can relate to finalizing various terms and conditions such as specifications, delivery packaging, insurance and so on.

The most import ingredient in the art of negotiation is communication. Therefore the essential techniques in negotiation are those, which are employed in the communication of ideas. Since negotiation involves convincing the other party of your point of view and reaching an agreement, communication skills, prove useful. It does not involve any science or mathematical formula. It is an art. Contracting officers use negotiated procurements whenever sealed bidding is not appropriate. Generally, negotiation is appropriate:

a) if item does not permit sealed bidding,
b) if award will be based on factors other than just price,
c) if discussions are necessary, or
d) if the Government is only aware of one source.

David Jones et al (1994:165) argued that there are alternative ways of reaching agreement that do not involve negotiations and can be appropriate and effective in the right circumstances. Some of these alternatives to negotiation are:

1) ***Persuade*****:** This involves encouraging the other party to accept the merits of a particular case with no concessions from yourself.

2) ***Give In***: That is, accepting totally what the other side offers.

3) ***Coerce:*** This is an insistence that the other side meets your demands or else.

4) ***Problem Solve*****:** This alternative removes the difference between the parties so that there is no need to negotiate.

3.1.1 Objectives of Negotiation

Generally speaking, the objective of negotiation is agreement. In other words, it is to persuade and convince the other side with your viewpoint and it must not be used to win an argument but to reach an agreement. This is one major difference between negotiations and a ball game or a war. Those activities, only one side can win; the other side must lose. In successful negotiation, both sides win something. Popular usage calls this approach, **win-win negotiation**.

Several objectives are common to all procurement/sales negotiations:

1) To obtain the quality specified.

2) To obtain fair and reasonable price.

3) To get the supplier to perform the contract on time.

In addition, the following objectives must be met:

a) To exert some control over the manner in which the contract is performed.

b) To persuade the supplier to give maximum cooperation to the buyer’s company.

c) To develop a sound and continuing relationship with competent suppliers.

d) To create long-term partnership with a highly qualified supplier.

3.1.2 When to Negotiate

In most cases purchasing orders are concluded on the basis of quotations received. Negotiations with the vendor will quite often follow after he has submitted his quotation, but sometimes negotiations take place as the first step in the purchasing deal. Negotiation is required when changes in the scope of a contract, call for changes in initial pricing and terms and conditions. Menon K.S. (1993:142) listed the following instances when the buyer and seller may consider negotiating:

1) Variations in the quality being purchased.

2) Changes in drawings and specifications.

3) Change in transportation, packaging or delivery point.

4) When supplies or services can be obtained from only one source. That it when competitive bidding is impractical

5) When no acceptable quotations are received from the responding vendors.

6) Price or other items and conditions of the contract, relating to large volumes of a large value, especially of scarce commodities where the contract relates to a long period.

7) When it is not practicable to draw up detailed specification and descriptions for certain service or supplies and these are required to be orally explained or clarified.

3.1.3 The Negotiator's Position and Qualifications

Purchasing executive and salesmen are individuals usually acting as representative of the various organisations that employ them. Their behaviour in negotiation will be influenced:

(i) by their personal characteristics,

(ii) which in turn will be partly determined by their roles, and

(iii) the situation in which they are negotiating.

3.1.3 (a) The Negotiator as a Representative

In negotiation, it is important for a buyer to know the extent of his authority to commit the organisation he is representing, since such authority prescribes his options and his responsibility for the outcome of the negotiation. The degree of authority he has as a negotiator may range from that of:

1) An emissary commissioned to present without variations, a position determined by his superior,

2) To that of being a free agent. And as a free agent, he can negotiate freely and even vary the stand taken by his company depending on the situation at the negotiation table. It is however recommended that the complex can open the negotiations, the greater should be the status of the negotiator(s).

There are five conditions that prevent a negotiator from responding spontaneously to his opposite number:

i) When a negotiator has little in determining his position.

ii) When he is held accountable for his performance.

iii) When he has sole responsibility for the outcome of the negotiation.

iv) When he is obligated to a constituency that is present during the negotiations.

v) When he is appointed rather than elected. In the above situations, a negotiator's behaviour is constrained by his obligations.

3.1.3 (b) Personal Characteristic of the Negotiator

The fewer the constraints imposed in a negotiator such as knowledge, experience and personality the wider the scope of his ability to influence the negotiation process. Studies have shown that personality variables such as anxiety, dogmatism, risk-avoidance, self-esteem and suspiciousness affect the degree of cooperation or competitiveness present in a negotiation situation.

3.2 The Process of Negotiation

In the broadest sense, negotiation begins with the origin of a firm's requirement for specific materials or services. According to Donald Dobler and David Burt (1996:363), actual two-party negotiation begins with a buyer's requests for proposals from potential suppliers. It develops as the negotiator carefully evaluates these proposals and prepares for discussion of the important issues that may arise in the impending negotiation conference. The negotiation process ends with the resolution of all issues that actually do arise during the negotiation conference. It is therefore useful to consider negotiation conceptually as a three-phase process.

- The first of the phases is the preparatory stage.
- The establishment of objective is the second stage.
- While face-to-face discussions, which result in agreement on all items and conditions of a contract or a decision not to enter into an agreement with the potential supplier is the third phase.

3.2.1 Preparation for Negotiation

It is arguable that over 90 percent of the time involved in a successful negotiation is spent in preparing for the actual face-to-face discussions. David Jones et al (1996:169) provided a list of key considerations as identified by Kennedy in the preparation for negotiation. This includes:

1) What do we want? Such want may for example include:

a) A lower price

b) An improved relationship

c) A bigger discount

d) Faster delivery

e) Changes in quality.

The range of negotiable variables in most buyer-seller relationships or transactions is very wide.

2) How valuable is each of our wants to us? Perhaps, for example:

a) Prompt delivery = high priority;

b) Lower price = medium priority; and

c) Quality changes = low priority.

3) What are my entry and exit point? As a negotiator, your point is really your opening bid. Once disclosed, you are unlikely to better it, so the bid obviously requires careful thought. The exit point is your walk away position. It is important that these facts be identified and understood at the preparatory phase. If only remove the possibility of striking an agreement, which may be regretted later. In addition, Dobler and Burt suggested that the negotiator must:

1) Know the item or service.

2) Know the seller's Bargaining Strength The seller's bargaining strength usually depends on three basic factors:

a) how badly the seller wants the contract;

b) how certain he or she feels of getting it, and

c) how much time is available to reach an agreement on suitable terms.

The buyer should encounter no difficulty in determining how urgently a seller wants a contract. The frequency with which the sales person calls, and general market conditions are positive indicators of sellers' interest.

3) Know the Buyer's bargaining strength. The buyer's bargaining strength depends on three basic factors:

a) The extent of competition present among potential suppliers

b) The adequacy of cost or price analysis; and

c) The thoroughness with which the buyer and all other members of the buying team have prepared for the negotiation.

4) Know the adequacy of cost or price analysis.

5) Know the Seller. 6) Know the thoroughness of buyer and negotiating team preparation.

3.2.2 Establishing Objectives

Meaningful objectives are essential to successful negotiating but rarely are such negotiation objectives meaningfully and clearly defined. Negotiation objectives must be specific. General objectives lower than previous prices; good delivery etc, are inadequate. For each term and condition to be negotiated, the negotiating team should develop three specific positions:

1) An objective position;

2) A minimum position, and

3) A maximum position.

The objective position for instance, is the negotiator's best estimate of what he or she expects to strike as an agreement. It can be very helpful to write down the agreed objectives(s) for the coming negotiation. Writing them down will serve to ensure that those involved know;

1) What is to be achieved; and

2) Upon what assumptions those objectives have been based.

It is important to recognise that the objectives, which are set, will be based upon an assessment of the situation within the given existing information. If some of the information proves to be faulty, then it may be necessary to change the stated objectives and probably the methods by which they are to be achieved.

3.2.3 The Actual Negotiation

The actual negotiation involves a four phase face-to-face negotiations and specifically the processes include:

1) Fact Finding

During the initial meeting with the potential supplier, the professional negotiator and the negotiating team limit discussions to face-finding. The important consideration is that during the face-finding session, the buyer and the supplier should attempt to analyse each other's point of view. The buying and selling representatives should disclose their interests – not their positions.

2) The Recess

While it may not be necessary to call for a recess in negotiation relative to small procurement, in major negotiations, it would be good strategy to call for recess after the face-finding session, to enable both teams to evaluate the facts and analyse the issues, assess the negotiating ability of the opposite team and, if needed, revise the issues. The duration of the recess depends on the circumstance and the issues involved.

3) Narrowing the Difference

When the formal negotiations reconvene, the negotiator defines each issue, states the facts, and attempts to convince the supplier's representatives(s) that the negotiator moves on to the next issue. During this phase of the negotiating process, problem solving and compromise are used to find creative solutions where both parties win. If a satisfactory agreement cannot be reached, the negotiating team has the choice of adjourning (an attractive alternative for buyer if another supplier is in the wings) or moving on to hard bargaining.

4) Hard Bargaining

Hard bargaining session is the last resort and this involves the use of take – it – or – leave – it tactics. Its use is limited to one –time or adversarial situation where long-term collaborative relationships are not objective.

3.2.4 The Post-Negotiation Phase

The primary activity of the post-negotiation phase is implementation. Successful negotiation is complete until what has been agreed is implemented. Only very ordinary or value free negotiators will pay insufficient attention to his aspect of the work. An effective negotiator would therefore need to take a number of necessary actions.

Firstly, skilled negotiators need to confirm with other party a clear understanding of what has been agreed.

Secondly, they also specify who is to do what, and by when, not only as between them and other party but also in their organization.

David Jones et al in their model of negotiation process provided the following prescriptive guidelines for the post – negotiation phase:

1) Produce the first draft agreement. This involves reporting in your own version what has been agreed, developing such agreement and sending your draft to the party for his comments and agreement

2) Ensure the commitment of people in your organisation to making the agreement work

3) Prepare official contract in line with the agreement

4) Remember no negotiation is successful until what has been negotiated is done.

5) Find time to evaluate performance, first, in negotiation, and secondly in, implementation.

Implementation of successful negotiation has the consequence of positively influencing the behaviour of both parties in future negotiations especially where purchasing transaction involves long-standing partners in the supply and demand market.

3.3 Negotiation Postures

Negotiators must be skilled at watching for, understanding and interpreting body language. No matter what people say, how they really feel can often be picked up from their body positions and gestures during the negotiations. You may consider that the other party is being honest and open, but this may not be true. You may equally feel the other side is happy; this also may not be the case. Therefore as a negotiator, you must watch for the body language.

A number of postures and what they might indicate have been provided by David Jones et al (1996 pp. 180) as shown in table 1 below:

Posture	Possible Meaning
Leaning forward when making A point	Interested; wants to emphasize a point
Avoiding eye contact telling	May be embarrassed; not The truth
Arms folded. Body turned away From you	Defensive; no compromise Not interested.
Body turned toward you leaning your Forward.	Interested; Warning toward Comments
Looking away to watch or at a further Window	Wants to leave or avoid any discussion
Hands supporting head and Leaning back in chair	confidence
Stroking nose regular with a Finger-avoid eye contact	May be lying.
Good eye contact. Fingers stroking saying Face.	Interested in what you are

Table 11.1 The Interpretation of Postures.

A negotiator should however interpret body language with sufficient caution. He/she may indeed be wrong. Nevertheless, it is a quality, that over a period of time, an experienced negotiator gets to understand the body language of the other side; this can greatly contribute to effectiveness at negotiation conference.

SELF ASSESSMENT EXERCISE

What would you regard as the conceptual facts about negotiation?

4.0 CONCLUSION

The objective of negotiation, it must be emphasized is agreement. Even though agreement is the fundamental goals of negotiation, negotiations occasionally end without agreement. In the short run, reaching no agreement is sometimes better than reaching an unsatisfactory agreement. By its nature, negotiation is a complex, fascinating subject, since it involves people, contains many variables. Generally speaking, however, experienced negotiators seldom let negotiations break down completely.

5.0 SUMMARY

However, defined, negotiation is more usefully seen as a process whereby agreement is sought. The most important ingredient in the art of negotiation is communication. Therefore the essential techniques in negotiation are those, which are employed in the communication of ideas. Since negotiation involves convincing the other party of your point of view and reaching an agreement, communication skills prove useful. It does not involve any science or mathematical formula. It is an art. In most cases purchasing orders are concluded on the basis of quotations received. Negotiations with the vendor will quite often follow after he has submitted his quotation, but sometimes negotiations take place as the first step in the purchase ideal. Negotiation is required when changes in the scope of a contract, call for changes in initial pricing and terms and condition.

6.0 TUTOR-MARKED ASSIGNMENT

Highlight in clear order the schematic process of negotiation.

7.0 REFERENCES/FURTHER READING

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UNIT 12: EXPEDITING OR FOLLOW-UP OF ORDER ----------126

Contents

1.0 INTRODUCTION

In order to achieve the purchasing aim of obtaining delivery on time, expediting is frequently undertaken. A dictionary definition of expedite is: assist the progress of something. In manufacturing industry, this activity may be undertaken in connection with the progress of a customer's order to the point of dispatch (this is internal expediting), or liaising with suppliers to ensure that materials are received from them or as scheduled (this is external expediting). In organisations providing a service rather than manufacturing anything, most of the expediting will be internal, and in manufacturing companies, it is the external expediting, which involves the purchasing function. Following-up the order to ensure prompt deliveries is an important function and this function is also variously called, progressing, expediting or follow-up.

2.0 OBJECTIVES

At the end of studying this unit, you should be able to:

• describe the nature of expediting work

• explain the expediting process

• state the characteristic of a good expeditor

• discuss the various methods of organization for expediting activity

• list the advantages of the expediting function.

3.0 MAIN CONTENT

3.1 The Nature of Expediting Work

Expediting is a planned, proactive task. As a concept, expediting is a purchasing responsibility/task of attempting to speed up delivery as the buyer's timing requirements undergo unexpected changes. More concisely, to expedite (a term that is used rather loosely in industry) involves actions to achieve an earlier delivery than originally planned. To de-expedite is indeed the opposite and this is to attempt to delay delivery beyond the original schedule delivery time. Expression such as hastening, progress chasing, and urging are sometimes used to describe the process of attempting to ensure that delayed supply of materials does not cause problems for the buying organisation. These expressions often indicate that process is seen as a reactive one, where a problem of lateness arises, and work then begins to try to save the situation. Ideally, the relationship between the selling and buying organisations is one of mutual trust and respect, and liaison, rather than expediting.

3.1.1 Elements of Expediting

The following elements are involved in expediting work i.e., the specific issues inherent in the follow-up job:

1) First, it is necessary to secure an acceptance of the purchase order by the supplier so also a promise of delivery

2) A proper record must be kept of due delivery dates and these records must be updated as and when deliveries arrive.

3) A review should be made of outstanding orders at regular intervals.

4) Communication should be made with suppliers as and when required. This can be through e-mail, telex message, phone calls, personal visits, etc.

3.2 Expediting Procedures

One very important matter relating to expediting is that all suppliers should be given strict instructions to inform the buying company as soon as some trouble is noticed about fulfilling delivery dates. If the suppliers can be trusted to do this, expediting becomes easier. Menon K.S. (1993:162) presented a simple procedure, which can be followed as follows:

1) Two copies of the purchase order are sent to the supplier and one copy to the expeditor.

2) The expeditor files the purchase order, vendor-wise, in a current file. This file is checked every week.

3) If the acknowledgement copy has not been received back within ten days, the expeditor should do the following:

(a) He should check back with the buyer if there has been any development in regard to the order; (for example, the supplier may have written that the term of agreement requires revision).

(b) If nothing has been heard from the supplier, he should send him a routine reminder.

(c) If within a week after the first reminder no acknowledgement has arrived, a letter should be sent, preferably by name to the official concerned in the supplier's company. If this fails, a telegram and a telephone call respectively should be the means of communication.

(d) Though the supplier has not formally accepted the order, he may have started supplies. In law, this is a proof of acceptance. The expeditor should check with the stores on this matter.

4) The expeditor will consult the file every week and take such action as is necessary for follow up.

5) When a delivery has been effected, the receipt section will send him a copy of the materials receipt note. The expeditor will make the relevant entries in the order copy. As soon as the order has been fulfilled, the copy of the order is removed from the file.

Follow-up procedures may be more elaborate than the one described above, but the basic elements are the same. Another point that must be made is that progressing activities does not commence until a reasonable period of time has elapsed; constant progressing can become counter-productive and results in sour supplier relationships. Figure 16.1 below shows a typical progressing format, indicating that progressing does not commence until a reasonable period of time has elapsed.

Date of Order	Jan Feb Mar June July Aug Sept
1st Jan	—— Estimated completion period →
Item A	→ Progress 1 → 2 →

Figure 4.1: Progressing Format

3.3 Characteristic of Good Expeditor

The work of an expeditor calls for considerable foresight, good judgment, initiative and intelligence to ensure that the right degree of attention is given to the various types of orders. A good expeditor must therefore have the following characteristics.

1) An expeditor must be a good communicator. An expeditor must be skilled at transferring information in a language that can be easily understood.

2) An efficient expeditor must be resourceful.

3) An expeditor must be a progressive individual, in other words, he must be capable of gingering up and building up pressure on the supplier.

4) Time consciousness and alertness is another characteristic. A good expeditor will know when to take strong action and how.

Expediting is not a routine function carried out by clerks. A supplier does not often have the courage to be honest and gives reports which do not commit him but which can be interpreted as encouraging by a buyer. A clever expeditor can see through such reports and distinguish the genuine from the misleading report.

3.4 Organisation for the Expediting Activity

There are various methods for organising for the follow-up activity. Indeed, there is a wide difference of opinions concerning the most effective arrangement for handling the expediting activity. Some firms require each buyer to do his/her own expediting. 1) Because of the buyer’s status and intimate knowledge of the order, these firms believe that a buyer can obtain more effective results from suppliers than can someone of lesser status in the organisation. 2) More important reason is that many companies using this approach want the buyer to assume total responsibility for each of his or her orders. They feel that the buyer can do this best by personally participating in all phases of an order and for all supplier contracts; it is easier to measure and control his or her performance.

Since much follow-up and expediting is a routine work, it often represents an inefficient use of a buyer’s time. Some companies therefore develop a hybrid organisation. To achieve the benefits of specialisation, they assign the follow-up and expediting function to a separate expediter. So that the buyer can retain full control of his or her orders, though, each expediter is assigned directly to one buyer (or a buying group).

Thus, the expediter does his or her work as directed by the buyer, and the buyer is helpfully accountable for his or her orders. In practice, the expediter usually handles all routine follow-up enquiries and calls on the buyer for assistance with the difficult or delicate expediting problems. Figure 16.2 shows a typical basic structure of organisation for the follow-up and expediting activity.

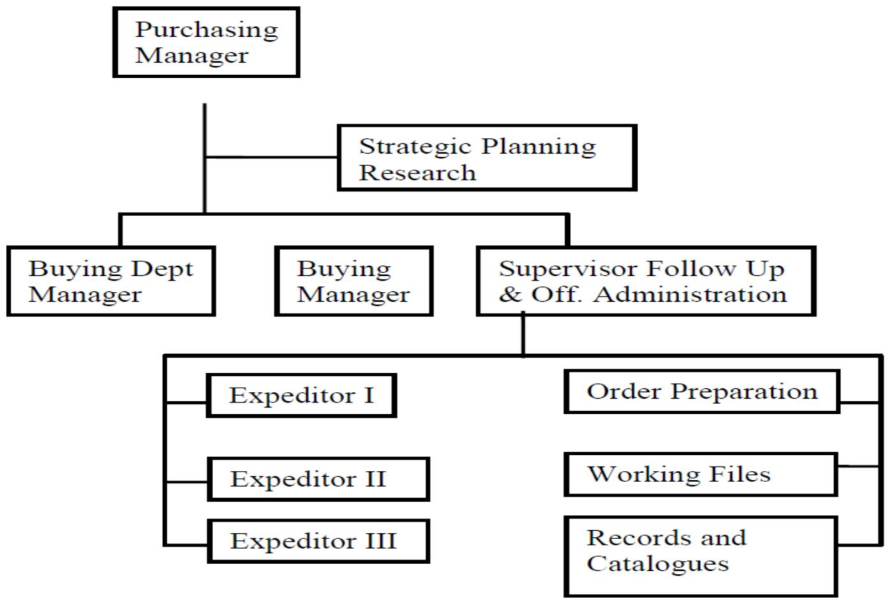

Figure 4.1: A Typical purchasing Organisation Internal structure showing the Expediting section

3.5 Adavantages of the Expedting Function

The progressing or follow-up activity has the following advantages:

1) The supplier is aware of the purchasing department's interest and control

2) Possible late deliveries or delays will be identified via the early warning system and therefore alternative suppliers can be secured or alterations of production programmes can be made, without loss of output.

3) The purchasing manager has a complete and updated visual picture of the purchasing department's position in term of ordering and suppliers.

SELF ASSESSMENT EXERCISE

List the basic characteristics of a good expeditor.

4.0 CONCLUSION

Expediting is an important function, which ought to be centralised. The term “expedite” is used rather loosely in industry. In a more precise sense “follow-up” involves activities to ensure delivery as scheduled. This function is absent in most of the companies. It is true that this function is irrelevant when you have an excellent relationship with the supplier, i.e., with the Electronic Data interchange (EDI) system where company’s computer constantly talks to the supplier’s computer and the company is able to follow the just-in-time system of inventory. Until this is into practice, expediting will ever be inevitable and must be available centrally.

5.0 SUMMARY

The systematic follow-up of the orders to secure the required delivery is an important purchase function. The purchasing department responsibility for an order does not terminate with the making of a satisfactory contract. Purchasing bears full responsibility for an order until the materials are received and accepted. The purchasing department will often have a wide range of outstanding orders at any given time, orders which are in process of being produced or obtained by the supplier. All these orders will beat various stages of completion. The purchasing executive must maintain a degree of control over this area of the purchasing function. To enable this control to be effective, a system of progressing has to be introduced and monitored.

6.0 TUTOR-MARKED ASSIGNMENT

Explain the issues involved in the follow – up procedure.

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UNIT 13 BUYING INTERNATIONALLY -------------------------------132

Content

1.0 INTRODUCTION

International purchasing is a rather complex discipline. Among the most significant business developments in the last four and half decades have been the rapid growth of international business and the proliferation of multinational firms. Although a number of companies have been engaged in this area for nearly a century, the explosive growth in the size and the number of international firms is a recent phenomenon, as is the much closer central control exercised by managements. Conceptually. "International business is business whose activities involve the crossing of national borders." This definition includes not only international trade and foreign manufacturing, but also encompasses the growing service industry in areas such as transportation, tourism, banking, advertising, construction, retailing, wholesaling, and mass communications. Today, international expansion has made international problems an organic aspect of purchasing and materials management. Indeed, international procurement is one of the most challenging aspects of purchasing and supply management.

2.0 OBJECTIVES

At the end of studying this unit, you should be able to:

1) define concept associated with buying internationally

2) list out and explain each of the approaches to international sourcing
3) state the benefits of buying internationally and the problems associated with it.

3.0 MAIN CONTENT

3.1 International Procurement Concept

Technically, international purchasing involves the performance of the purchasing activities across the national boundaries. International sourcing, or purchasing goods from sellers in other countries for internal use or resale, can be risky, as there is an increasing need to understand foreign environments, purchasing methods and the techniques of adapting purchasing management processes and organizational behaviour to new and different conditions. Dobler and Burt (1996:267) argued that, more recently, the term “foreign sourcing” has largely been replaced with “international sourcing”, the process of purchasing from suppliers outside of the firm’s country of manufacturing. At a number of leading firms, international sourcing is being replaced with a broader international approach called “global sourcing”. Professors Monczka and Trent (1991:3) defined global sourcing; “…as the integration and coordination of requirements across worldwide business wait, looking at common items, processes, technologies, and supplier.” This unit essentially focuses on the benefits, risks of and approaches to international sourcing.

3.2 Approaches to International Sourcing

With ever increasing global competition and demands for continuous cost improvement, today’s purchasing management is being challenged with the question, “Are we buying from the best place in the world?” Depending on your company’s internal resource, skill sets, and long-term strategies, there are many ways to obtain the answer. In this section, attempt will be made to discuss the advantages and disadvantages of the following five most common methods that local companies can use to approach international sourcing:

• Nigeria Sales Contacts of Foreign Suppliers
• Nigeria Global Sourcing Companies
• Overseas Sourcing Representatives
• Direct to Suppliers
• International Procurement Office (IPO)

3.2.1 Nigeria Sales Contacts of Foreign Suppliers

Nigeria Sales Contact of Foreign Suppliers abound in the country and exist in all traditional supplier forms including sales representatives, agents, distributors, Importers, direct sales officers, Trading Companies, Brokers etc. They are distinguished from other global sourcing approaches in that they are undisputedly working on behalf of the supplier.

Buyers approach to them is essentially the same as traditional domestic/local supplier relationships and this of course is their greatest advantage since they generally make buying from overseas extremely simple They generally handle all communications, logistics, import, contractual, and pricing issues on behalf of the foreign supplier to the point that the local purchaser may not even know the name of the foreign `Supplier. Sparing the purchaser from dealing with the many issues that shall be discussed later in the Direct Approach is of course a great advantage; particularly if the purchaser is limited in resources and skill sets, however we should point out the disadvantages.

3.2.2 Nigeria Global Sourcing Companies

Purchasers can take advantages of the capabilities and experience of the Nigeria Global Sourcing Company as in the case of many areas in international business; this segment is not well defined so that purchasers can find these Sourcing Companies having numerous classifications.

Whether they are called Trading Companies, Third Party Sourcing, Importers, Brokers, Global Search or Sourcing Companies they represent the purchaser and not the supplier. The advantages of using the Nigeria Global Sourcing Company approach can be summarised by stating that they can make buying internationally as simple as buying from the Supplier across the street. Usually they provide the following services:

1) Determine items suitable for global sourcing
2) Locate and develop suppliers
3) Negotiate pricing 4) Determine logistics and import costs
5) Coordinate formal evaluation process 6) Place and administer orders
7) Handle communication & Translation
8) Administer Quality Programme
9) Accept financial risk
10) Handle currency issues

1) Pay the supplier

12) Administer logistics and importation processes

13) Pay freight, duty, insurance, broker and other import costs

The major disadvantages of using Nigeria Global Sourcing Companies for global sourcing fall under the categories of (1) increased price, (2) reduced control, and (3) the failure to develop internal capabilities that may be essential to maintaining competitiveness.

Although Sourcing Companies do not usually restrict direct communication between the purchaser and supplier, as a practical matter, most communications flow through the Sourcing Company. As a result, the beneficial exchanges between purchaser and supplier personnel who have specific product knowledge may not occur, and product or process improvements may be missed.

3.2.3 Overseas Sourcing Representatives

Overseas Sourcing Representative (OSR) can be a valuable resource in the Purchaser's efforts to determine the best value in the world. They are based in and usually are citizens of the target country who have extensive knowledge in purchasing, the capabilities of the local supplier base, and acting as buying representative for Foreign Purchasers. They range in size from one-person operations to companies with large staff members with numerous departments specialising in specific commodities. They routinely provide the following services:

1) Understanding the Purchaser's requirements

2) Guidance in selecting viable opportunities

3) Translating 4) Finding and qualifying potential suppliers

5) Helping potential suppliers understand Purchasers

6) Obtaining Quotes

7) Negotiations with Suppliers

8) Arranging for evaluation visits by Purchaser and escorting purchaser while in the country

9) Insure order entry

10) Resolve Issues

11) Facilitate communications

12) Expedite for delivery

13) Resolve any quality issues

14) Handle Shipping

15) Orders can be placed on OSR who will place on supplier

16) OSR may make payment to Supplier

17) OSR may perform or arrange for inspection

18) OSR may take full quality and financial responsibility

Just like Nigeria Global Sourcing Companies, OSRs can greatly speed-up and improve the success rate of international buying projects. Although it is not like buying across the street, since the purchaser must communicate internationally and usually handles all import details, the OSR does give the Purchaser what amounts to an experienced purchasing department in that country. Since most OSRs work on commission paid by the purchaser, the purchaser does not incur a cost unless the OSR come up with a good Supplier used by the purchaser. This is both good and bad news, since the OSR will not continue to support the Purchaser's Global Sourcing efforts unless there are financial successes for the OSR along the way. Finding the best supplier in a country is:

1) Usually made easier by using an OSR since they know the reputations of the Suppliers and are more likely to find the small obscure suppliers who often offer the greatest values.

2) OSRs can be invaluable in negotiations since they know the customs, culture, and the objectives of the Supplier in ways not known or easily understood by the Purchaser.

3) OSRs also have the ability to make in country visits by the purchaser much more productive since they handle the logistics.

4) The ability of many OSRs to provide technical expertise and perform or arrange for quality inspection.

The major disadvantages in using an OSR are that:

1) They will add 5 to 20% to the direct material cost.

2) Although there are many potential OSRs in each country, their capabilities and performance vary widely so that purchasers have to exercise a great deal of due diligence in the selection process.

3) Additionally OSRs are usually good in just one country or in some cases good in only one major city, so that if an area such as Asia is targeted, the Purchaser will have to select OSRs for each targeted country

4) Since OSRs may also be limited in product expertise, specialising in stamping, castings, or electronic For example, purchasers having varied product categories to source may do well to have multiple OSRs.

3.2.4 Direct

With today's improved communications and the availability of high quality Suppliers all over the world, many purchasers deal directly with the Supplier in the foreign location without the use of any third party. According to a survey reported in the purchasing journal (April, 1997), of those who source overseas, use the direct approach.

When considering whether or not to use the Direct Approach, Purchasers must first understand that all the services identified above as being by Nigeria Global Sourcing Companies and OSRs, will have to be provided by the Purchasers in the Direct Approach. This means that the following skill sets among others will have to exist or be developed by the Purchaser for maximum success in international Sourcing:

1) Targeting countries
2) Locating suppliers in targeted countries
3) Selecting suitable products
4) International and country specific business practices
5) Understanding the foreign supplier's capabilities, expectations, and needs.
6) International terms and conditions
7) Dispute resolution
8) International negotiations
9) Communications
10) Understanding cultural differences
11) Inspection at foreign locations
12) Payment methods
13) International transportation, insurance, etc.
14) Import process, regulations and duties
15) Country specific export regulations
16) Currency exchange
17) International order administration and overseas expediting
18) Packaging for international shipments In addition to the above skill sets, the purchaser must also have available the financial and human resources to carry out the Global Sourcing Process.

These resources often involve the need for additional people and considerable monies for travel, research, training, qualification and approval. For most purchasers, the decision to go Direct should be based on;

1) The expected volume of international purchases,

2) The commitment to long-term international sourcing strategies and

3) The internal resources available.

The direct approach cans results into the advantages of;

1) greater control

2) development of internal capabilities,

3) avoiding the country references of third parties, and

4) obtaining lower total material cost.

3.2.5 International Procurement Office (IPO)

Having an International Procurement Office (IPO) is "actually" having the Purchaser's own Procurement Operation located overseas. An IPO is owned and operated by the purchaser, staffed with the purchaser's employees and does sourcing only for the Purchaser. IPO while providing all of the services defined above for the OSR, also gives the following advantages to the Purchaser over the OSR.

1) No third party mark-ups
2) Dedicated overseas resource with no other
3) Direct in –country purchaser interface with the supplier
4) Development of long-term in –country relationships with government and business community.
5) Better communications by direct interface with purchaser's engineering, production, and quality groups.
6) Reduces purchaser's need for foreign travel.
7) Better in-country quality and engineering support.
8) Greater flexibility to coordinate with other purchaser's overseas entities such as sales offices, manufacturing plants. joint ventures, etc. to obtain advantages in administrative cost, taxes, currency, human resources, import / export status, logistics, etc.

With all the valuable services provided by IPOs and the above advantages, why do not all international Purchasers use them? The major reasons are that they are:

1) Costly and challenging to operate;

2) Usually difficult to staff, and

3) Add to the Purchaser's head count.

Even with an IPO, the purchaser must still develop import capabilities. These issues notwithstanding and because of their many advantages, IPOs should be considered when:

1) there is sufficient annual volume to cover expenses,

2) a long-term –commitment to the country or region, and

3) the direct approach is not providing the expected results.

3.3 The Benefits and Risks of International Sourcing

3.2.4 Why Purchasing International Goods and Services

International sourcing requires additional efforts when compared with domestic sourcing, but it can yield large rewards.

1) Quality

A key reason for international sourcing is to obtain the required level of quality.

2) Timeliness

A second major reason for purchasing international goods and services is, generally, the dependability of the supplier in meeting scheduled requirements

3) Cost

International sourcing generates expenses beyond those normally encountered when sourcing domestically. Nonetheless after all of the additional costs of "buying international" are considered, in the case of many materials it frequently is possible to reduce the firm's total cost of the materials through international sourcing.

4) Product and Process Technologies

No country holds a monopoly on new technology. International sources in some industries are more advanced technologically than their domestic counterparts. Not to take advantage of such product or process technologies can result in a manufacturer's losing its competitive position *vis-a-vis* manufacturers that incorporate the new technologies.

5) Broadening the Supply Base

Professional buyers want to develop and maintain an adequate supply base for required materials. It may be necessary to develop international suppliers in order to have a competitive supply base. In some cases, there may not be a qualified domestic source.

6) Counter Trade

Many countries require their non-domestic suppliers to purchase materials in their country as part of the sales transaction. These arrangements commonly are called barter, offsets, or counter trade.

3.3.2 Problems Associated with International Procurement

1) Culture and Communications

The nature, customs, and ethics of individuals and business organisations from two different cultures can raise a surprising number of obstacles to successful business relations. What is considered ethical in one culture may not be ethical in another. Differences in culture, language, dialects, or terminology may result in miscommunication and cause problem.

2) Payment Terms Conditions

rom the buyer's point of view, the preferred method of payment is after receipt and inspection of the goods. However, it is customary in many countries for advance payments to be made prior to commencing work. Such a provision ties up the purchaser's capital.

3) Long Lead Times

Variable shipping schedules, unpredictable time requirements for customs activities, the need for greater coordination in international purchasing, strikes by labour unions, and storms at sea (which can cause both delays and change) usually result in longer lead times.

4) Additional Inventories

The quantity of additional inventory needed when purchasing from foreign sources can be difficult to determine quite often, however, the additional inventories are not as large as one might expect. Nevertheless, inventory –carrying costs must be added to the purchase, the freight, and the administrative costs to determine the true total cost of buying from international sources.

5) Quality

As previously mentioned, international suppliers frequently are utilized because many of them can provide a consistently high level of quality. But problems do exist. Non-domestic suppliers tend to be less responsive to necessary design changes than do their domestic counterparts.

6) Higher Costs of Doing Business

The need for translators, communications problems, the distance involved in making site visits, and so on all add to the cost of doing business with international suppliers. Port-order services are more complicated because of currency fluctuations, methods of payment, customs issues, and the utilisation of import brokers and international carriers. Inadequate local (international) logistical support functions such as communication systems (telephones, telexes, and fax machines), transportation systems, financial institutions, and so forth can complicate communications and product distribution.

SELF ASSESSMENT EXERCISE

What are the services of the global sourcing companies in the international procurement functions?

4.0 CONCLUSION

International sourcing, or purchasing goods from sellers in other countries for internal use, resale, can be risky, as there is an increasing need to understand foreign environments, purchasing methods and the techniques of adapting purchasing management process and organisational behaviour to new and different conditions. Today, international expansion has made international problems an organic aspect of purchasing and materials management. Indeed, international procurement is one of the most challenging aspects of purchasing and supply management.

5.0 SUMMARY

With ever increasing global competition and demands for continuous cost improvement, today's purchasing management is being challenged with the question, "are we buying from the best place in the world?' Depending on your company's internal resources, skill sets and long-term strategies, there are many ways to obtain the answer. Today, international expansion has made international problems an organic aspect of purchasing and materials management. Indeed, international procurement is one of the most challenging aspects of purchasing and supply management.

6.0 TUTOR -MARKED ASSIGNMENT

Would you advise your manufacturing company to have an international procurement office?

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UNIT 14 MANAGING PURCHASING ACTIVITIES --------------142

Content

1.0 INTRODUCTION

Like other key management tasks, procurement has aspects that are concerned with operational activities (day-to -day), with tactical matters (medium term-perhaps up to one year), and with strategic issues (long term). Management is a process or activity, which takes place at all levels in an organisation. It is not carried out only by people with 'manager' in their job title. Departmental heads, supervisors, foremen, bishops, presidents or even Boy's scout leader all performs managerial function; although obviously not all of the same type or of equal importance. It is the task, which a person performs which is of importance, not the job title. Hence, managers whoever they may be, tend to have the same set of functions in an organisation. The task of managers is to get results through their subordinates. This he does by planning, organising, directing and controlling. These activities are called management functions, because they identify broadly what managers do. These managerial functions are generally considered central to a discount of management by authors.

4.0 OBJECTIVES

At the end of studying this unit, you should be able to:

• define planning and apply planning steps to your procurement activities

• discuss and state the implications of budgeting and purchasing research activities to the purchasing function.

3.0 MAIN CONTENT

3.1 The Planning Process and Techniques for Materials Management

The purchasing department must have a plan for carrying out its activities. In fact, managerial efficiency starts with planning. Without a plan, purchasing will be carried out in a stab-and grab opportunistic manner, and the department may be very much overloaded during some months and be relatively without much work for the rest of the year. The first function of management is therefore, the development of a series of plans that establishes the framework within which future activities will be conducted. Every managerial job demands that planning be done before the other functions of management are executed. Planning, simply put, is a decision-making process that pertains to the future. It involves all activities leading to the formulating of objectives and deciding upon the means of meeting them. A useful working definition of planning is given by the Chartered institute of Management Accountant (CIMA) as:

> *The establishment of objectives and the formulation, evaluation and selection of the policies, strategies, tactics and actions required to achieve these objectives.*

Every planning process practically speaking attempt to answer such questions as;

- What action should be taken?
- Why should the action be taken?
- Who shall take the action? and
- How shall the action be taken?

Planning is not an end itself, its primary purpose is to provide the guidelines necessary for decision and resulting action, throughout the organisation. Planning is done on both the formal and informal basis and the planning process uses information from both the internal and external sources. The plan is the net result of the planning process. A plan is a predetermined course of action about what has to be done to achieve an objective. At the beginning of the year, the purchasing department must determine what to buy and when. It must have time-schedules and a programme for purchase. In purchasing, time is so essential. A plan can be simple or complex. It can cover the short-term or the long term.

1) Long-Term or Strategic Plans

These are plans designed by top managers to meet or achieve the company –wide or corporate objectives. It involves a longer time period say two –to- five (and in some cases longer) years and relies on more unreliable long – term forecasts.

2) Short Range or Operational Plans

This shows how strategic plans will be implemented in day-to-day activities. Operational plans thus cover some functional areas such as production, marketing, finance etc. and periods of up to a year and such other situations that are likely to come up monthly, weekly and sometimes daily.

3.1.1 The Planning Steps Regardless of its complexity, most planning can be done in a relatively simple series of steps. Hence, managers would follow essentially, the same process or step in any thorough planning. Certain of the steps are however easily accomplished, but in practical terms, the series of steps are of general application. Koontz et al (2000) presented the steps which constitute the rational decision – making process to include:

1) Discovering an opportunity to exploit or problem to solve

(2) Establishing (planning) objectives

(3) Determining and, or considering planning premises

(4) Determining alternative courses of action

(5) Evaluating the alternative courses of action

(6) Selecting a course

(7) Implementation

(8) Planning review (control).

3.2 Planning Techniques for Materials Management

In preparation for each new fiscal year, most firms construct a company-wide annual operation plan. A forecast of the scope and magnitude of key functional activities is the starting point for development of the plan. In a manufacturing firm, this is the sales forecast. The sales forecast is then translated into an aggregate production plan and master schedule, taking into consideration finished goods inventory levels as well as desired in – i.e. process inventory levels for specific items. All materials planning subsequently flows from the preliminary master production schedule. Materials managers apply the basic concepts of planning techniques, formally and informally, in making a multitude of daily business decisions. Dobler D.W. (1981) identified and extensively discussed three widely used techniques in materials planning, namely; budgeting, purchasing research and network analysis, and planning.

3.2.1 Budgeting

Budgets are one of the traditional planning and control tools of business and are used in organisations of all types. A budget may be defined as a financial plan showing anticipated income and expenditure for a period of time, for the purpose of attaining a given objective. CIMA specifically defined a budget as: A plan quantified in monetary terms, prepared and approved prior to a defined period of time, usually showing planned income to be generated and/or expenditure to be incurred during that period and the capital to be employed to attain a given objective. Budgets are usually prepared for both individual departments and the business as a whole. The basic concept of the budget is to balance expenditure with income. The budget should help ensure that expenditure is not exceeding income on an ongoing basis; it is once – a year exercise. A well-prepared budget helps management in several ways. Perhaps its primary functions are to;

(1) Serve as a guide in planning financial operations within the company.

(2) A second purpose is to establish limits for departmental expenditures.

(3) A third purpose of budget is to act as a coordinating device among the various functions of the business.

(4) A fourth purpose of budgets is that of control.

All department heads typically prepare a budget for their area of responsibility and submit it to the controller. A company budget, thus, typically composes of numerous sub-budgets, each covering specific departmental operational activities. This is graphically illustrated in figure 14.1 below:

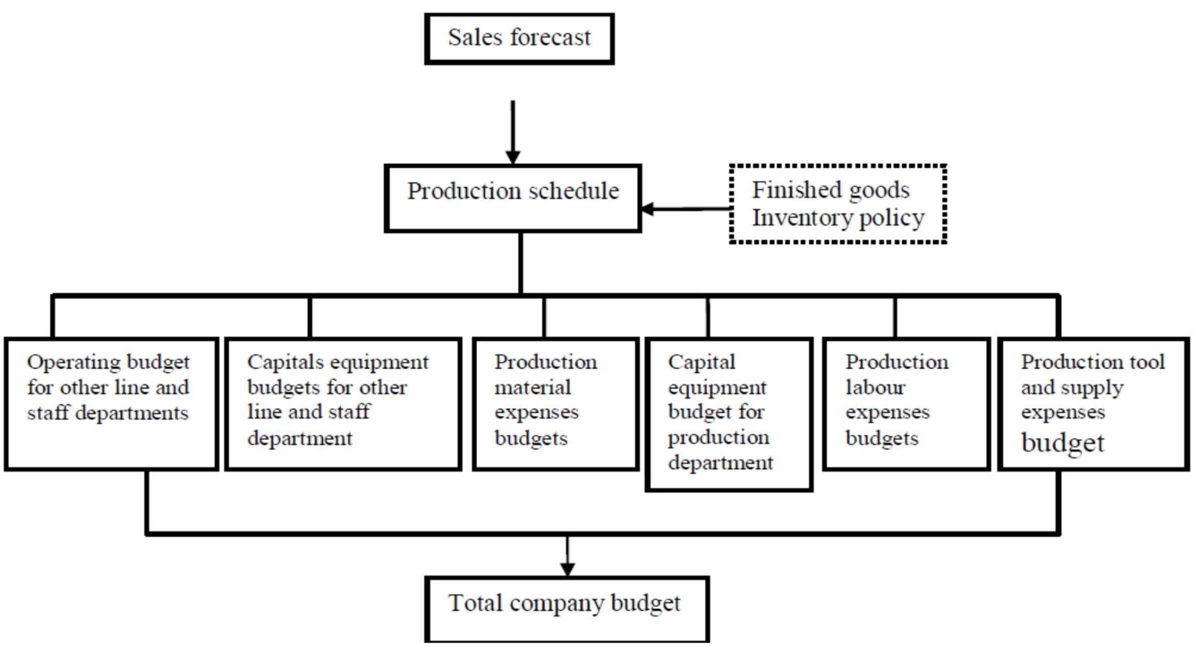

Figure 14.1: Major constituents of a total company budget.

Materials are however, primarily concerned with two budgets the materials budget and their respective departmental operating budgets.

1) Purchase (Materials) Budget

The purchase budget is based entirely upon the sales and production budgets. In theory, the purchasing function extrapolates (i.e. work out) materials requirements from the production budget projects prices and thereby phasing deliveries in accordance with production schedules. The implication is that detailed preparation of annual materials budgets is therefore realistic only for those products whose sales can be forecasted with reasonable accuracy or for materials that are used in a variety of products whose aggregate demand can be forecasted. When purchasing budget is to be expressed in terms of naira, the purchasing manager is normally called upon to supply the budget department with two types of information:

i. Estimates of materials prices during the coming year, and
ii. Plans for the specific timing of purchases.

Timing of purchases is vital in respect of cash management, which needs to control the amount to cash required during each period. The task of estimating price trends however requires the consideration of many things including;

a) Political or economic factors, or domestic, which may affect price;
b) Comparative currency changes and levels of inflation in pertinent countries;
c) Possible changes in import duties, transit and insurance charges, etc. as they affect from overseas;
d) The position of long term contracts as regards fixed prices;
e) The supply position of materials and components in relation to overall demand;
f) Lead times and the potential effects of having to purchase from more expensive alternative sources in the event of failure.

2) **The Departmental Operating Budget**

This budget is essential for the effective planning and control of departmental operations. Along with other departmental heads, the procurement manager makes periods. This is estimate of the costs, which will be incurred during the budgetary period. This estimate is usually produced annually and will include;

(1) Total departmental salary bill

(2) Total expenses for the period

(3) Total cost of departmental supplier; and

(4) Capital expenditure.

Without doubt, costs vary widely among firms. However, small business organisation pay more over every naira value purchase made to operate their purchasing departments than do large firms, and operating costs tend to be higher among durable goods producers than among non-durable goods producers.

3.2.2 Purchasing Research

In the planning stages, most purchasing actions require certain research investigations. Because he is confronted with numerous unknown facts, an industrial materials buyer cannot make an enlightened purchasing decision until these unknown areas are explored. The formal purchasing research concept recognises the need for generating and analysing a sizable amount of detailed data when planning procurement operations. If the required data is available or can be developed effectively in other existing departments, the job of the purchasing research group is to obtain such information and organise it for use in purchasing.

If the information is nowhere available with the firm, it is the purchasing research staff's job to generate it. Hence as a concept, purchasing research has been defined as: The responsibility concerned with the process of obtaining, organising, and interpreting data, which facilitate procurement planning and hence improve the total materials management operation. A formal purchasing research programme serves as a procurement planning tool. The general objective of such a programme is to undertake in-depth investigations, which improve total procurement performance and increase the function's contribution to company profits. Operationally, the purchasing research work can be accomplished in several ways.

(1) Some company's purchasing and supply departments include these activities as parts of a senor buyer's job.

(2) In a majority of the more progressive firms, however, this purchasing research work is assigned to a group of staff specialists who specifically trained in these activities. Lanner Lee Jr. (1981, p. 388) listed a number of developed classifications of purchasing research staff functions, which has since been adopted by numerous firms. This includes; (1) Procurement planning (2) Research on purchased materials

(3) Research on the purchasing system

(4) Special projects.

(1) Purchasing Planning

This involves the study of the company's short and long- range materials requirement and a determination of acceptable cost objectives.

(2) Research on Purchased Materials

This involves both economic and technical investigation. In the economic area, forecasts of general economic conditions are made, and studies of the industries and commonly markets are undertaken.

Technical investigations primarily focus on two major programmes, which are frequently conducted on a company-wide basis –make- or buy and value analysis.

(3) Research on the Purchasing System

This research classification involves studies of administrative problems. Specific activities include the analysis of such things as policies, procedures, reports, organisation structures, job specification, wage payment plans, and so on.

(4) Special Projects

This is often a fourth area of informal purchasing research activity. Staff assistance is frequently needed to study a multitude of special problems that arises in areas such as inventory management, traffic management, quality control, and vendor relations, for example.

3.3 Purchasing and Record Keeping

The procurement department is obliged to maintain a complete set of records regarding the operations and activities of the department. Good record keeping is germane to the achievement of the purchasing and inventory management objectives, of making available the right product, in the right quantities, at the right time, in the right place. The file of a purchasing department thus contains an endless flow of operational data. The information stored will include details of the following:

(1) Suppliers' past performance and evaluation of them. Technically this is a record of closed orders. (2) Current price of goods and services required by the organisation.

(3) Copies of orders, contracts and current agreements. All buyers need immediate access to information concerning the status of their outstanding orders.

(4) Specification and standards as set by the user department.

(5) Supplier Record: To provides quick access to information in a single record file. A separate card or computer is maintained for each major supplier. In this record is recorded the address telephone number, and the name of personnel to contact on specific matters of inquiry.

(6) Contract Record: Today, most firms are purchasing an increasing number of items on a long-term contractual basis. In such cases, it is usually convenient to consolidate all contracts in a separate file. (7) Progressing data for outstanding

3.4 Handling Orders

In procurement, various types of orders exist. This depends largely on a number of factors such as:

(1) The nature of the business;

(2) The characteristic of the various materials needed,

(3) The market structure,

(4) The quantity required of each item as well as the frequency of need. For this reason, the various types of orders are classified as follows, depending on the circumstances surrounding each requirement.

(1) Small Orders

Small orders are a perennial problem in every organisation and a serious problem in some. Recent research evidence has shown that most companies' expenditure is on small orders that are hardly more than ten percent of their annual materials expenditure. The very nature of business requires the purchase of many low-value items. Small orders are however not only costly to the buyer but also to the seller. Various methods are nevertheless in use by managers to minimize the small-order problem.

(2) Rush Orders

Purchasing basic responsibility is to its internal customer, i.e. the various departments in an organisation. In serving its customers, the concern is to develop an orderly and systematic pattern of operation that efficiently utilizes the resources to that organisation. This situation calls for approaches to deal with the problem of handling emergency needs that inevitably arise in any business operation. A clear, special procedure for processing rush requisition in all organisations. Rush orders always cost more than if they were handled through the normal purchasing system. High prices are frequently paid because rush purchases are not as thoroughly investigated as those handled in the normal routine. To discourage the incidents of rush orders that arise because of poor planning, David N. Burt (1996p. 79) presented three approaches that have proved successful overtime.

(i) The first involves a concerted effort to coordinate the activities of the user departments and purchasing.

(ii) A second approach is to reduce unjustifiable requests which require the requisitioner to obtain approval from a general management executive for all emergency requisitions.

(iii) The final approach assesses the requisitioning department for a predetermined service charge for each emergency requisition processed.

(3) Centralised Stores System

A store system is the first approach typically used to reduce the frequency and volume of small-order-purchasing activity. When experience shows that the same supply items are ordered in small quantities time after time, the logical solution is to order these items in larger quantities and place them in a centralised store or inventory for withdrawal as needed.

(4) Blanket orders

A blanket order system is designed to solve the problem a company's inability to carry thousands of items as inventory just like a central stores system is designed to solve the small order problem only for items that are used repetitively.

• On the basis of careful analysis of past purchases, the buyer determines which materials should be handled through blanket orders.

• After bidding or negotiation, the buyer selects a supplier for each items, or family of items, and issues a blanket order to each supplier.

• The blanket order typically states that all requirements are to be delivered upon a receipt of an order from the buyer or other authorized person.

• On receiving a requisition for one of the materials, the buyer merely sends a brief order form to the supplier. On the release or order form are noted the blanket order number, the item number, and the quantity to be delivered.

The blanket order system offers a number of advantages:

1) Clear reduction in the issuance of purchase orders and clerical work in purchasing, accounting and receiving.

2) It releases buyers from routine work, giving them more time to concentrate on major problems

3) It permits volume pricing by consolidating and grouping requirements.

4) It develops longer-term and improved buyer-supplier relationships. Blanket order system nevertheless requires adequate internal control to function effectively. Absence of this control element can encourage petty fraud and poor supplier performance. The elements essential to effective control are:

i. A numbered purchase order

ii. A record of authorised delivery releases.

iii. Bona fide evidence of receipt of the materials.

In spite of the several benefit of this method of handling orders, the blanket order has not enjoyed popular applications in business organisations.

5) System Contracting

As the name implies, system contracting involves the development of a company-wide agreement, often a one to five year requirements contract, with a supplier to purchase a large group (or family) materials. It can be viewed as an extension and more sophisticated development of the blanket order – purchasing concept.

Estimate usage is usually included, along with a fixed price for each item and an agreement by the supplier to carry an adequate stock of each item to meet the buyer's needs. Various types of supplies and commonly operating equipment, typically purchased from distributors, are the materials most often covered by these types of agreements.

6) The Telephone Order System

Most companies now use a telephone or fax ordering system to reduce the paperwork associated with small – order purchasing. Under this system, when the purchasing department receives a requisition, it does not prepare a formal purchase order. Instead, the order is placed by telephone or fax, and the requisition is used in the receiving procedure. This system goes one step further in the elimination of paperwork; the firm's suppliers send no invoice for telephone purchases.

7) Electronics Order System

A number of electronic communication systems currently are available to transmit materials purchase requests without writing orders or talking on the telephone. One particular approach that evolved is the internet and electronic commerce. Meaningful studies and research findings have shown that the internet and e-commerce have become a vivid representative of core business parameters today around the world. There is now a tremendous amount of activities as companies begin to set – up their customer service functions on the internet. The system is particularly applied to the purchase of repetitively used items whose recurring orders can be placed using the same input source. Clearly, the use of an electronic ordering system requires a blanket order or similar contractual arrangement with the supplier.

8) Petty Cash System

Most firms today use a petty cash fund for making small, onetime purchase. For this purpose, many firms defined small as under N 20,000. it is often less expensive for an individual user to buy minor items personally and pay for them a petty cash fund than it is to buy them through the conventional purchasing system, any inefficiency that may arise because of lack of buying skills is more than compensated for by the administrative saving resulting from not placing a purchase order.

3.5 Ethics in Purchasing

In many respects, ethics is far more important in today's procurement environment than it has ever been in the past. Whereas before there was adversarial relationship between buyers and suppliers, today there is partnership. Procurement chain or circle management is the reason behind this change, and it is a process which requires a high level of trust in order for the partnership to work to the mutual benefit of both the buyers and sellers.

Ethics has more significance to purchasing personnel who deals with many suppliers, evaluate them and award them contracts. Attempts will naturally be made to seek favour with him and, as such, he is subjected to temptation day in and day out, it becomes imperative, therefore, that all public and private sectors' purchasing personnel be entirely cognizance of the necessity for ethical behaviour. It takes only slightest limit of impropriety to cause doubt on behaviour, whether through perception or an actual event. As a concept, ethics simply means what is right. Ethics involves learning what is right or wrong and simply doing it.

Many philosophers consider ethics to "be the science of conduct". Ethics has therefore been broadly defined as: "Standards of conduct that distinguish between right or wrong, good and bad, virtue and vice, justice and injustices." Purchasing from the layman's definition simply means the act of buying or to acquire. Ethics in purchasing means what is right in the act of purchasing. It implies the various dos and don'ts of the purchasing profession, which has to do with one's behaviour, and conducts in purchasing practice. More specifically, purchasing ethic has been defined as: 'Concerning the rightness or wrongness of actions taken by purchasing professional while pursuing the business goals of his or her organisation'. Purchasing ethics primarily concentrates on what is the correct behaviour of a purchasing professional as he performs his duties dealing with the acquisition of goods and services in order for his company to produce a product or provide a service.

3.6.1 Division of Ethics

Ethics in procurement is divided into values, norms and rules conduct. These are further enumerated below:

a) Value Value is this context is used to mean moral or professional standard to behaviours in purchasing, and this includes:

(1) Honesty/Integrity
(2) Responsible management
(3) Serving the public interest
(4) Professionalism

b) Norms of Ethical Behaviour

In procurement, the following standard or pattern of social behaviour is expected among the professionals:

1) To consider first, the interest of one's organisation in all transaction.

2) To strive for increased knowledge of materials and processes of manufacturing.

3) To participate in professional development programmes.

4) To subscribe to and work for honesty in buying and selling.

5) To accord a prompt and courteous reception to all who call on a legitimate business mission.

(6) To abide by and to encourage others to practice the professional code of ethics of the Nigerian Institution of Purchasing & Supply Management (IPSM) and its affiliated institutes and corporations. 7) To counsel and assist fellow purchasers in the performance of their duties.

8) To cooperate with all organisations and individuals engaged in activities, which enhance the development and standing of purchasing and materials management.

9) To be receptive to competent counsel from one's colleagues and guided by such counsel without impairing the responsibility of one's office.

10) To buy without prejudice, seeking to obtain the maximum value for each naira of expenditure.

c) Rules of Conduct

In applying these rules of conduct, personnel involved in purchasing should follow the guidance set out below:

(1) Declaration of Interest

(2) Confidentiality and Accuracy of Information

(3) Competition

(4) Business Gifts and Hospitality

To preserve the image and integrity of those involved in purchasing and the profession. Business gifts other than items of small intrinsic value should not be accepted.

(5) Environmental Issues.

Anyone involved in purchasing should recognise their responsibility to environmental issues consistent with their corporate goals or missions.

SELF ASSESSMENT EXERCISE

Highlight the series of simple steps involved in most planning.

4.0 CONCLUSION

It is important to emphasis that in many organisations, purchasing is a primary function and therefore a key influence on the business. In other words, there is a necessary requirement to buy materials and equipment in order to produce, and without those purchases the business could not function. When this situation is linked to the fact that the average manufacturing company spends well over half its income on buying goods and services, it is clear that the management of purchasing should command the attention of the company's top management level. A materials manager's responsibilities however differ little from those of other functional manager's. All managers function primarily as decision makers. Although the details involved in managing a purchasing department differ from those involved in managing an engineering or production department, the basic managerial activities are the same. All managers develop the specific pattern of activity required in their own functional areas by applying the same general management concepts.

5.0 SUMMARY

The procurement department must have a plan for carrying out its activities. In fact, managerial efficiency starts with planning. Without a plan, purchasing will tend to be carried out in a stab-and-grab opportunistic manner, and the department may be very much overloaded during some months and be relatively without much work for the rest of the year. The first function of management is therefore, the development of a series of plans that establishes the framework within which future activities will be conducted. Every managerial job demands that planning be done before other functions of management are executed. Dobler D.W (1981) identified and extensively discussed three widely used techniques in materials planning, namely; budgeting, purchasing research and network analysis and planning. The purchasing department is obliged to maintain a complete set of records regarding the operations and activities of the department. Good record keeping is germane to the achievement of the purchasing and inventory management objectives, of making available the right product in the right qualities, at the right time, in the right place.

The significance of computerisation for procurement and materials management is readily understood when one considers the amount of purely administrative work involved in the procurement cycle of the average buying company. Literally, thousands of requisitions, requests for quotation, purchase orders, change orders, status reports, receiving records, invoices, and other documents must be processed and recorded. Today, a computer based system for handling these activities is a necessity.

6.0 TUTOR-MARKED ASSIGNMENT

State clearly the basic materials based activities that can be well performed by a computer based system.

7.0 REFERENCES/FURTHER READING

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UNIT 15 DELIVERY PERIOD, TERMS OF DELIVERY, TRANSPORTATION, TRANSIT INSURANCE, DELAY IN SUPPLY, CANCELLATION OF CONTRACT--------------------156

Content

1.0 INTRODUCTION

In this unit, the issues concerning Delivery Schedule including Transportation & Transit Insurance and various aspects covering Delays in Supply will be discussed.

2.0 OBJECTIVE

At the end of studying this unit, you should be able to;

Discuss with demonstrable examples, terms and conditions that are associated with delivery, insurance, delay and cancellation of purchased goods

3.0 DELIVERY PERIOD, TERMS OF DELIVERY, TRANSPORTATION, TRANSIT INSURANCE, DELAY IN SUPPLY, CANCELLATION OF CONTRACT

3.1 Delivery Period

The period for delivery of the ordered goods and completion of any allied service(s) thereof (like installation and commissioning of the equipment, operators’ training, etc.) are to be properly specified in the contract with definite dates and the same shall be deemed to be the essence of the contract.

Expressions such as ‘immediate’, ‘ex-stock’, “as early as possible’, ‘off the shelf’, etc. must not be used to indicate contractual delivery period.

3.2 Terms of Delivery

The terms of delivery is decided depending on the nature of goods to be purchased, transportation facility available, location of the user, location of the prospective suppliers etc. Terms of delivery *inter alia* determine the delivery point of the ordered goods from where the purchaser is to receive / collect the goods. Terms of delivery have direct bearing on the quoted prices.

3.3 Linkage between Terms of Delivery & Date of Delivery

Delivery dates in respect of contracts incorporating standard and commonly used terms of delivery shall be deemed to be as follows:

Terms of Delivery	Date of Delivery
Ex-Works	The date the supplier delivers the goods to the purchaser at its (supplier's) factory/premises.
FOR, Station of Despatch **(**FOR stands for Free on Rail)	The date on which the goods are placed by the supplier on rail with clear RR (Rail Receipt).
FOR, Destination	The date on which the ordered goods reach the destination railway station specified in the contract.
CIP, Destination (CIP stands for Carriage and Insurance paid)	The date on which the delivery is effected at the destination mentioned in the contract.
Local Delivery at Site	The date on which the delivery is made at the consignee's site mentioned in the contract.
FAS, port of shipment (FAS stands for Free Alongside Ship)	The date on which the supplier deliver the goods alongside the vessel at the specified port of shipment. This date is reflected in the Bill of Lading.
FOB, **port of shipment** (FOB stands for Free on Board)	The date on which the supplier delivers the goods on vessel's board at the specified port of shipment. This date is reflected in the Bill of Lading.
CIF, **port of destination** (CIF stands for Cost, Insurance and Freight)	The date on which the goods arrived at the destination port.

It must be pointed out that the FAS, FOB & CIF terms of delivery are applicable for goods which are directly imported from foreign countries against the subject contract and not imported already by the supplier under its own arrangement. The CIP terms of delivery may be applied both for domestic as well as imported supplies.

3.4 Instructions for Transportation of Imported Goods

As per the general policy of Government of Nigeria, all import contracts are to be concluded on FOB / FAS basis. In case a Ministry / Department desires any departure from the above policy including placement of contracts for import of foreign goods, prior permission is required to be obtained from Ministry of Surface Transport.

In case of FOB/FAS contracts, shipping arrangements shall be made by the Shipping Co-ordination and Chartering Division/Shipping Co-ordination and Officer, Ministry of Transport. Notice about the readiness of Cargo for shipment shall be given by the supplier from time to time at least 6 (six) weeks in advance for finalising the shipping arrangement, through Fax/Telex and courier, to the Chief Controller of Chartering, Shipping Co-ordination Officer, Ministry of Transport.

Within 3 (three) weeks of receipt of the advance notice, as above, the said Chief Controller of Chartering, Shipping Coordination Officer will advise the supplier, through Fax/Telex and courier when and on board what vessels, these goods or such part thereof are to be If the advice for shipping arrangement is not furnished to the supplier within 3 (three) weeks as aforesaid or if the vessel arranged is scheduled to arrive at the specified port of loading later than 15 (fifteen) days of the date of readiness of cargo, as aforesaid, the supplier may arrange for such transport on alternative carriers with the prior written consent of the purchaser.

Where the supplier is required under the contract to deliver the goods on FOB/FAS basis and to arrange on behalf and at the expense of the purchaser for ocean transportation on Indian flag vessels or vessels of conference lines in which India is a member country, the supplier may arrange for such transportation on alternate carriers if the specified Indian flag vessels or conference vessels are not available to transport the goods within the time period(s) specified in the contract, with the prior written consent of the purchaser.

Should the goods or any part thereof be not delivered on the nominated vessel (except in case where prior written consent of the purchaser was obtained), the supplier will be liable for all payments and expenses that the purchaser may incur or be put to, by reason of such non-delivery including dead and extra freight, demurrage of vessels and any other charges, whatsoever incurred by the purchaser.

The supplier shall not arrange part-shipments and/or transhipment without the express/prior written consent of the purchaser. Where the supplier is required under the contract to deliver the goods under CIF/CIP terms, no further restriction shall be placed on the choice of the ocean carrier except that the shipment shall be made by vessels belonging to the conference lines in which Nigeria is a member country.

It is also important to point out that before processing any case for placement of contract on FAS/FOB/ CIF/CIP basis for imported goods, the purchase organization should check the contemporary government instructions in this regard for further necessary action.

3.5 INCOTERMS

Unless otherwise specifically agreed to by the purchaser and the supplier and incorporated in the contract, the applicable rules & regulations for transportation of goods from foreign countries will be as per the contemporary version of International Commercial Terms (Incoterms) evolved by International Chamber of Commerce, Paris. Incoterms are the official rules for worldwide interpretation about the duties, obligations, etc. of the buyer and the seller for transportation of the goods from seller's country to buyer's country. Incoterms are recognised by the United Nations Commission on International Trade Law (UNCITRAL) as the global standard for such interpretation. The purchasing Ministry/Department, while ordering goods for importation from foreign countries are to take note of the same.

3.6 Air Consignment

As per the extant directive of the Government, airlifting of the imported goods from abroad will be done only through the National Carrier or any other like the Air Afrik wherever applicable. However, before processing any contract involving import of goods through air, contemporary instructions in this regard may be ascertained and followed.

3.7 Insurance

Wherever necessary, the goods supplied under the contract, shall be fully insured in a freely convertible currency against loss or damage incidental to manufacture or acquisition, transportation, storage and delivery in the manner specified in the contract. If considered necessary, the insurance may be done for coverage on "all risks" basis including war risks and strike clauses. The amount to be covered under insurance should be sufficient to take care of the over all expenditure to be incurred by the purchaser for receiving the goods at the destination.

It is also important to point out that insurance of imported goods/equipment would need to be arranged on a very selective basis and only for cases where the value of individual shipment is expected to be in excess of million of naira.

Where delivery of imported goods is required by the purchaser on CIF/CIP basis, the supplier shall arrange and pay for marine/air insurance, making the purchaser as the beneficiary. Where delivery is on FOB/FAS basis, marine/air insurance shall be the responsibility of the purchaser.

3.8 Distribution of Despatch Documents for Clearance/Receipt of Goods

The supplier shall send all the relevant despatch documents well in time to the purchaser to enable the purchaser clear or receive (as the case may be) the goods in terms of the contract. Necessary instructions for this purpose are to be incorporated in the contract. The usual documents involved and the drill to be followed in general for this purpose are as follows:

(i) For Domestic Goods

Within 24 hours of despatch, the supplier shall notify the purchaser, consignee, …….. (others concerned), the complete details of despatch and also supply following documents by registered post / speed post (or as instructed in the contract):

(a) Supplier's Invoice indicating, *inter alia* description and specification of the goods, quantity, unit price, total value;

(b) Packing list;

(c) Certificate of country of origin;

(d) Insurance certificate;

(e) Railway receipt/Consignment note;

(f) Manufacturer's guarantee certificate and in-house inspection certificate;

(g) Inspection certificate issued by purchaser's inspector and

(h) Any other document(s) as and if required in terms of the contract.

(ii) For Imported Goods

Within 24 hours of despatch, the supplier shall notify the purchaser, consignee, …….. (others concerned), the complete details of despatch and also supply following documents by air mail / courier (or as instructed in the contract):

a) Supplier's Invoice giving full details of the goods including quantity, value, etc.;

b) Packing list;

c) Certificate of country of origin;

d) Manufacturer's guarantee and Inspection certificate;

e) Inspection certificate issued by the Purchaser's Inspector;

f) Insurance Certificate;

g) Name of the Vessel/Carrier;

h) Bill of Lading/Airway Bill;

i) Port of Loading;

j) Date of Shipment;

k) Port of Discharge & expected date of arrival of goods and

l) Any other document(s) as and if required in terms of the contract.

3.9 Installment Delivery

The goods ordered in a contract to be delivered by installments may be an "entire" contract or a "severable" contract as per illustrations given below:

i) Entire Contract: Total number of units of the required goods is100.

Delivery Schedule: Delivery to commence after 30 days of placement of contract and to be completed within 4 months @ 25 units per month i.e., completion by 30.06.2006 or earlier.

ii) Severable Contract: Total number of units of the required goods is 100.

Delivery Schedule: 25 units by 31.03.2006; 25 units by 30.04.2006; 25 units by 31.05.2006; 25 units by 30.06.2006.

In the case of a severable contract, each instalment constitutes a separate contract and extension in delivery period, if needed is to be done for each installment separately. If goods are accepted after expiry of the delivery date of a particular installment without extension in delivery period being given with reservation of right to liquidated damages etc., the purchaser will not be legally entitled to claim the liquidated damages etc.

Therefore, in case of severable contract, the purchaser should watch delivery position of each installment as per the specified date for that installment, and, whenever necessary, extend the corresponding date for the installment in question or cancel that installment, in which there is delay in supply.

3.10 Delay in Supplies for which Supplier is not responsible

Normally, in the following circumstances, the contractual delivery period needs to be re-fixed to take care of the lost period, without imposing any penalty to the supplier.

i) Cases where the manufacture of stores is dependent on the approval of the advance sample and delay occurs in approving the sample though submitted by the supplier in time.

ii) Where extension in delivery period is granted on account of some omission on the part of the purchaser which affects the due performance of the contract by the supplier.

iii) Cases where the purchaser controls the entire production. The delivery cannot be re-fixed to make a contract a 'severable' contract without the specific agreement of the supplier, if the delivery originally stipulated in the contract was in the form of an 'entire' contract.

3.11 Force Majeure

Force Majeure means an event beyond the control of the supplier and not involving the supplier's fault or negligence and which is not foreseeable. Such events may include, but are not restricted to, acts of the purchaser either in its sovereign or contractual capacity, wars or revolutions, hostility, acts of public enemy, civil commotion, sabotage, fires, floods, explosions, epidemics, quarantine restrictions, strikes, lockouts, and freight embargoes.

If there is delay in performance or other failures by the supplier to perform its obligation under its contract due to event of a Force Majeure, the supplier shall not be held responsible for such delays/failures. If a Force Majeure situation arises, the supplier shall promptly notify the purchaser in writing of such conditions and the cause thereof within twentyone days of occurrence of such event. Unless otherwise directed by the purchaser in writing, the supplier shall continue to perform its obligations under the contract as far as reasonably practical, and shall seek all reasonable alternative means for performance not prevented by the Force Majeure event. If the performance in whole or in part or any obligation under this contract is prevented or delayed by any reason of Force Majeure for a period exceeding sixty days, either party may at its option terminate the contract without any financial repercussion on either side. There may be a Force Majeure situation affecting the purchase organization only. In such a situation the purchase organization is to take up with the supplier on similar lines as above for further necessary action.

3.12 Remedies to Purchaser for delay in Supply / Non-Supply for which Supplier is responsible

The purchaser has the following options depending upon the circumstances of the case:

i) Extend the delivery with imposing of liquidated damages and other denial clauses

ii) Forfeit the performance security

iii) Cancel the contract

iv) Impose other available sanctions/penalties

3.13 Liquidated Damages

There should be a suitable provision in the terms & conditions of the contract for claiming liquidated damages of appropriate amount from the supplier to take care of delays in supplies and performance, for which the supplier is responsible. Such recovery through liquidated damages should be without prejudice to the other remedies available to the purchaser under the terms of the contract. Depending on the nature and value of the goods to be ordered and the urgency of the requirement, a specific percentage of the delivered price of the delayed goods (or delayed services) for each week or part thereof delay, is to be incorporated in the contract terms. Generally, the percentage is 0.5% per week or part thereof. There should also be an appropriate maximum limit of such deduction, to be shown as a specific percentage of the contract value of delayed supplies/services and incorporated in the contract terms. This percentage is generally 10%. Any lower ceiling should be clearly justified while formulating the contract.

3.13.1 Token Liquidated Damages.

There may be situations when charging full Liquidated Damages may not be justified as the reasons for delay in delivery by the supplier may be largely due to circumstances well beyond under his control but nevertheless these may not considered adequate to waive off liquidated damages altogether or there may be such deficiencies in service for which quantification may not be feasible and no other remedy may be available. In such cases, at the sole discretion of the purchaser, Token Liquidated Damages up to 10% of the normal Liquidated Damages may be imposed by the Competent Financial Authority with the approval. Stipulations to this effect, prescribing the kind of deficiencies and scale of Token Liquidated Damages chargeable should be clearly brought out in the tender documents. This safeguard should be consistent with the provisions of Performance Security

3.14 Extension of Delivery Period

If the supplier is unable to complete the supply within the stipulated delivery period for which the supplier is responsible, it (supplier) is required to request for extension of delivery period.

If the purchaser agrees to extend the contractual delivery schedule, the same may be done by issue of an amendment to the contract with suitable denial clauses and with imposition of liquidated damages for delay.

The amendment letter is to mention, *inter alia* that, in addition to imposition of liquidated damages, no extra price or additional cost for any reason whatsoever beyond the contractual cost will be paid to the supplier for the delayed supply; at the same time, if for any reason, whatsoever the cost of the goods to be supplied/services to be performed by the supplier decreases that benefit will be passed on to the purchaser. Supplier’s unconditional acceptance of the amendment by a specified date is to be watched and if the supplier does not agree to accept the amendment letter, further action is to be taken against the supplier in terms of the contract.

3.15 Performance Notice

A situation may arise where the supply/services has not been completed within the stipulated period due to negligence / fault of the supplier; however the supplier has not made any request for extension of delivery period but the contracted goods/services are still required by the purchaser and the purchaser does not want to cancel the contract at that stage. In such a case, a Performance Notice (also known as Notice-cum-Extension Letter) may be issued to the supplier by suitably extending the delivery date and by imposing liquidated damages with denial clauses etc. on identical lines as above.
Supplier’s acceptance, etc. of the performance notice and further action thereof should also be processed in the same manner as mentioned above. The text of the Performance Notice will be on similar lines to the model extension letters with suitable modifications as required.

3.16 Despatch of Goods after expiry of Delivery Period

As per the contract terms, the supplier is not to supply the goods when there is no valid delivery period. In case the supplier makes any supply after expiry of delivery period, the purchaser/consignee can reject the supplies and inform the supplier accordingly; the purchaser shall also have the right to cancel the contract (w.r.t. unsupplied goods) in terms of the contract. If, however, the purchaser / consignee requires the goods (which has been supplied after expiry of the delivery period), the purchaser may accept the goods and issue a delivery extension letter with usual LD clause and denial clauses, as mentioned earlier, to regularize the transaction.

3.17 Correspondence with the Supplier after Breach of Contract

The purchaser or its authorized representative is not to enter into correspondence after expiry of the delivery date stipulated in the contract because such a correspondence will make the contract alive. This situation will not allow the purchaser to cancel the contract straight away without first serving a performance notice to the supplier.

However, even after expiry of the delivery period of the contract, the purchaser may obtain information regarding past supplies etc. from the supplier, simultaneously making it clear to the supplier that calling of such information is not intended to keep the contract alive and it does not amount to waiving the breach and that it is without prejudice to the rights and remedies available to the purchaser under the terms of the contract.

3.18 Cancellation of Contract for Default

The purchaser may, without prejudice to any other remedy for breach of contract, by written notice of default sent to the supplier, terminate the contract in whole or in part:

a) If the supplier fails to deliver any or all of the stores within the time period(s) specified in the contract, or any extension thereof granted by the Purchaser; or

b) If the supplier fails to perform any other obligation under the contract within the period specified in the contract or any extension thereof granted by the purchaser.

In the event the purchaser terminates the contract in whole or in part; the purchaser may take recourse to any one or more of the following action.

i) the Performance Security is to be forfeited;

ii) the purchaser may procure, upon such terms and in such manner as it deems appropriate, stores similar to those undelivered, and the supplier shall be liable for all available actions against it in terms of the contract.

iii) however, the supplier shall continue to perform the contract to the extent not terminated.

Before cancelling the contract and taking further action, it may be desirable to obtain legal advice from the Legal Wing of the Ministry/Department or from the Ministry of justice.

3.19 Termination of Contract for insolvency

If the supplier becomes bankrupt or otherwise insolvent, the purchaser may, at any time, terminate the contract, by giving written notice to the supplier, without compensation to the supplier provided that such termination will not prejudice or affect any right of action or remedy which has accrued or will accrue thereafter to the purchaser.

3.20 Termination of Contract for Convenience

After placement of contract, there may be some unforeseen situation compelling the purchaser to cancel the contract. In such a case, the purchaser is to send a suitable notice to the supplier for cancellation of the contract, in whole or in part, for its (purchaser's) convenience, *inter alia*, indicating the date with effect from which the termination is to become effective.

Depending on the merits of the case, the purchase organization may have to suitably compensate the supplier on mutually agreed terms for terminating the contract. Suitable provisions to this effect are to be incorporated in the tender document as well as in the resultant contract.

4.0 CONCLUSION

Sometimes it becomes necessary for the purchase organization to conduct type test, acceptance test or special test at outside laboratories, when facilities for these tests are not available in-house with the supplier or carrying out of confirmatory tests is considered desirable before accepting the goods. Ministry/Department should draw up a list of approved laboratories for this purpose, to whom the samples drawn from the lots offered by the supplier can be sent for tests. The list should also contain approved laboratories, which can be used as referral/appellate laboratories for retest, when samples tested at one laboratory are decided to be re-tested.

5.0 SUMMARY

Evaluation of tenders is one of the most significant areas of Purchase Management. The entire process of tender evaluation and placement of contract must be transparent. In this unit we have extensively discussed the issues relating to the purchased goods delivery Period, terms of delivery, transportation, transit insurance, delay in supply, cancellation of contract. Depending on the terms of delivery and the projected requirement, all the applicable components of the costs, as quoted in the responsive tenders, are to be added to work out the ultimate evaluated costs of the tenders.

6.0 TUTOR MARKED ASSIGNMENT

Under what condition may a contract be terminated in whole or in part?

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