

ORGANIZATIONAL PURCHASING : ITS OBJECTIVES, ACTIVITIES, AND FACTORS RELATED TO THE SELECTION OF SOURCES OF SUPPLY

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I. INTRODUCTION

Earlier marketing scholars looked at marketing as a subject which was concerned with both buying and selling. Consequently, organizational purchasing emerged as an important area of marketing. However, with the emergence of the marketing concept following World War II, marketing scholars and practitioners emphasized the importance of marketing activities from the seller's point of view. Purchasing, accordingly, became a neglected subject, and marketing curriculum, at American schools of business reflected this development. However, recent views of some marketing educators give a great deal of importance to purchasing as marketing function. ¹ Purchasing has been also considered an important business function by many firms.

Three events contributed to the change of business philosophy which resulted in viewing purchasing as a major business function. The shortage of both materials and qualified suppliers resulting from unexpected increase in demand for all types of goods during World War II clearly demonstrated the importance of effective purchasing to the wellbeing of manufacturing concerns. Besides, increasing intensity of competition in many major industries resulted in the need to cut costs in order to survive and to protect profit margins. Management, then, started searching in all elements of cost. Since the expenditures by the average industrial company on materials and services it purchases from outside suppliers range from 40 to 60 per cent of sales, anything contributing to the reduction of this element of cost would be of great help in reducing total cost and in increasing profit margins. However, the rapid change and technological development caused expenditures on materials and equipment to increase. This necessitated searching for new ways and methods of developing the purchasing function.

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¹ Philip Kotler and Sidney Levy, "Buying is Marketing Too," *Journal of Marketing*, Vol. 37 No. 1 (January 1973) pp. 54-59.

II. Buyers of Industrial Goods Versus Buyers of Consumers' Goods:

Goods can be classified broadly into consumer goods and services, and industrial goods and services. The differences between these two types of goods do not arise from variation in their physical characteristics as from differences in the ways and the purposes of buying them. Consumer goods and services are bought by individuals for personal or household use. Industrial goods, on the other hand, are bought by business firms and other organizations for use in the conduct of such enterprises. Behavior patterns of the buyers of these two types of goods result largely from differences of purposes for which buyers purchase them. Consumer goods are usually bought in small quantities, many times by individual buyers, and often through decisions based upon habits rather than careful consideration of the purchase situation. Besides, they are bought by many people, and some of them are bought by everybody. Personal taste and preferences are the dominant factors underlying the behavior of buyers of these goods.

Although buyers of consumer goods and services are similar to buyers of industrial goods and services in that both acquire such goods and services to serve a purpose, the objectives to be achieved through purchases are different for each group. The objective of a buyer of consumer goods is almost always the personal satisfaction of the buyer or someone associated with him in a family or friendship relation. But the objective of an industrial buyer that he aims to achieve through his purchase of industrial goods is usually the making of profit or, sometimes, the operation of an enterprise. Goods purchased by business firms or organizations may be used for the purpose of increasing productivity of an operation, a reduction in its cost or an increase in the salability of the end products or services.

Industrial goods are mostly bought by corporations and organizations. They are usually bought in large quantities. Each purchase may affect the cost structure of a buying firm, and influence its operations and end products. Therefore, decisions of making purchases are based upon careful consideration of the effects of such purchases on a firm's operations and profit. Moreover, such purchases are negotiated by professionals whose business is to buy. Impulse, whim, and emotion are minor factors in determining behavior of industrial buyers. The profit that may be realized from the use of goods purchased, or their effect on the operating efficiency are the dominant factors motivating the industrial buyers' behavior. 2

Types of Industrial Buyers:

Buyers of industrial goods, who purchase such goods for use in carrying out their business activities are distinguished from buyers for the purpose of resale. The chief groups of buyers of industrial goods are manufacturers,

2. For a more elaborate discussion of industrial goods and their characteristics see E. Jerome McCarthy, *Basic Marketing: A Managerial Approach* (Homewood, Ill., Richard D. Irwin, Inc., 1971), pp. 321-341.

service industries, contract construction companies, commercial enterprises, governmental units, certain professional groups such as doctors, and other nonprofit organizations. The most important group of these is the manufacturing group. The purchase of industrial goods by commercial enterprises is confined largely to furnitures and fixtures, cleaning materials, wrapping and packing materials, stationary, and business machines. The purchases of professional groups of this type of goods include mainly items that are highly specialized as well as other items such as stationary items.

III. Purchasing.

Purchasing is one of the basic functions of business that are directed toward achieving company objectives. On the average, half of a manufacturing firm's income from its sales is spent on goods and services by the purchasing department. This fact makes evident that every dollar saved in purchasing is a new dollar of profit. Applicable expenses must be deducted before obtaining net profit. Besides, additional profit from purchasing savings can be achieved with little increase in expenses, sometimes without any increase at all. Additional profit from increase in sales volume, however, requires increase in expenses as well as increase in the risk of capital. All these factors make evident the importance of the purchasing function's profit making potential. Efficiency in performing this function will, accordingly, increase the opportunities for profit of an enterprise.

Objectives of Purchasing.

The purchasing responsibility is sometimes defined as buying materials of the right quality, in the right quantity, at the right time, at the right price from the right sources. This definition describes the objectives of purchasing in a broad way. However, the basic objectives of purchasing may be stated as follows. 3

1. To secure materials, equipment, and other supplies necessary for an organization's operations. The purchasing function must be performed so efficiently as to minimize or eliminate interruption of production resulting from shortage of supplies.
2. To keep inventory investment and inventory losses resulting from obsolescence and theft at minimum.
3. To buy both competitively and wisely. Buying competitively means trying to be free of forces that greatly increase prices and restrict availability of materials. To buy wisely, on the other hand means to get the goods that are best suited to company operations and end-products. This does not, however, necessitate obtaining the

3 Stuart F. Heinritz and Paul V. Farrel **Purchasing: Principles & Applications**, (Englewood Cliffs, N. J. : Prentice-Hall, Inc. 1965), p. 7; and Lamar Lee, Jr. and Donald W. Dobler, **Purchasing and Materials Management** (New York: McGraw-Hill Book Company 1965), pp. 11-12.

highest quality. It rather involves search for offers that include the best combination of price, quality and service.

4. To develop reliable multiple sources of supply.
5. To develop good supplier relationships. Such relationships are important in solving problems that arise between a company and its suppliers. This would also make a vendor willing to give advance information on new products and prices, and provide better service.
6. To achieve maximum coordination and integration with the other departments of the firm. This involves providing concerned departments with information received from suppliers regarding materials and prices. Besides, the purchasing department should understand the needs of each department so that it can secure the goods and services suitable for such needs.

These objectives apply in principle to all types of organizational buyers: manufacturing concerns, governmental units, hospitals, and all other types of institutions that do not buy for purpose of resale. The principles are also applicable to all sizes of organizations, although in some situations, some changes in some of the objectives may be required to make them fit a particular organization.

Purchasing activities.

The purchasing department, trying to achieve the objectives of purchasing, performs a variety of activities. Typical activities of a purchasing department include the following:

1. Recognizing the needs of using departments of various supplies and precise description of such needs.
2. Selection of sources of supply.
3. Ascertaining prices of items purchased.
4. Placing the order.
5. Follow-up of the order.
6. Checking invoices
7. Maintenance of records and files.
8. Developing and maintenance of vendor relations.
9. Traffic management.
10. Receiving purchases.
11. Inspection of goods purchased.
12. Storekeeping.
13. Inventory control.
14. Scrap and surplus disposal. 4

⁴ For detailed discussion of purchasing activities, see J. H. Westing, I. V. Fine and Gary Joseph Zenz, **Purchasing Management: Materials in Motion** (New York: John Wiley & Sons, Inc., 1969), pp. 10-22.

IV. Selection of Sources of Supply.

The process of the selection of a supplier is one of the most important function of purchasing. The complexity of the process, however, depends largely on the item purchased. It is much simpler for an item which is bought frequently and does not require substantial funds than for a new item or an old item involving substantial expenditures. The process will be more formal and systematic in the latter case.

Selection of acceptable and willing vendor is necessary to make a satisfactory purchase. Some suppliers may not be capable of providing desired quality standards or can not provide adequate service; others may not be able to supply the amounts needed at the same time they are needed; still others who may be able to meet these requirements but are not willing to sell at the desired price. The purchasing officer must find the vendor who can provide the optimum combination of all the pertinent factors of quality, price, service, and delivery schedules. Money and effort spent on careful selection of sources of supply usually prove to be a good long-term investment. Proper selection of suppliers makes it both easier and more economical for issuing orders in the future. Frequent dealings will also increase confidence on both sides. Moreover, periodic reviews of suppliers are easier to make when the buyer and seller are on friendly terms as a result of frequent dealings with each other.

The selection of good suppliers is indispensable to the relationships between the purchasing department and the using departments within the organization. The choice of suppliers is usually left to the purchasing department as long as the using departments are satisfied with the quality, amount and prices of materials they obtain. If departments find that supplied materials are not satisfactory, they are likely to insist on specifying suppliers. This of course will make the purchasing department lose control over purchasing, and as a result, the morale of this department will suffer serious harm.

Sources of Information about Suppliers.

The process of selecting a supplier starts with preparing a list of prospective suppliers. Some purchasing officers rely on their past experience and their memory for their knowledge of sources of supply. This practice may be satisfactory when the items are simply, repetitive in nature, and do not require large amounts of funds. However, since human memory is uncertain, and sometimes biased, it is important to maintain records of actual and potential sources of supply for efficient operation of the purchasing department. Beside past experience and memory, there are other sources of information about suppliers. The principal sources consist of trade directories, trade journals, salesmen's interviews, catalogues, trade shows and conventions, and vendor records.

Trade directories:

Trade directories include lists of manufacturers according to the products they make on a nation-wide basis. They provide some other information on such matters as size of manufacturers, their financial status, their methods of distribution, and location of sales offices. Some trade directories are specialized by industries. They include all companies within specific industry and their products as well as other pertinent data. Besides, there are regional directories issued by State Chambers of Commerce as well as local classified telephone directories. Most of these directories contain enough information to enable the purchasing officer to prepare a tentative list of possible suppliers.

Trade Journals.

Trade journals are other useful sources of information about suppliers. The purchasing officer should choose from different kinds of business magazines those publications dealing with the fields in which his firm has primary interest. In general, trade journals are not useful as directories to be consulted as the need arises. Rather, they are considered general sources of information on new products and methods which are usually described in the advertisements or the editorial pages.

Salesmen.

Salesmen are considered one of the valuable sources of information on matters regarding sources of supply, types of products, and trade information generally. Although in most cases salesmen information relates to their own companies, a salesman may be able to give information about a source of supply for an item that his company does not sell. Because of the importance of salesmen as a source of information, many purchasing officers make it a practice to see as many salesmen as they possibly can. Many buyers maintain a record for each salesman containing data that they expect to be valuable in the future. In addition, some companies have provided their purchasing personnel with suggestions concerning the relations between the purchasing office and the vendors' representatives in recognition of the importance of salesmen as a source of information.

Although the purchasing executive is expected to be familiar with his company's operation, materials, equipment, and other needs, and be qualified to carry salesmen's suggestions and proposals to the using department, he does not, as a rule, have the technical qualifications of a specialist. Therefore, he should refer proposals and suggestions by technical salesmen regarding products of interest to department heads when necessary.

Catalogues.

Catalogues constitute a valuable source of information on suppliers. They are utilized by the majority of purchasing agents for this purpose, especially in cases of standard items. The effectiveness of catalogues as a source of information on suppliers depends, to a large extent, on the

form in which the catalogue is published and the manner in which catalogues are filed and indexed. The size and shape of the catalogue has a great effect on the filing process of catalogues. Recognition of the importance of catalogues as a source of information on suppliers and types of products induced many large companies to appoint a librarian whose job is to maintain the catalogue file as one of her duties.

Trade shows and conventions.

The trade show or convention is another source of information about suppliers. Some industrial groups hold trade shows during various times of the year. The members of an industry display their products at a trade show in an attempt to attract buyers and build up their interest. The trade convention, on the other hand, is a meeting of members of an association, held primarily for the purpose of the exchange of ideas. In some conventions, members of an association are able to display their equipment and materials. Such conventions are ideal places for a supplier to show his products to potential customers. They also enable buyers attending them to find out about new products and other possible sources of supply.

Vendor files.

Vendor files contain information concerning the address of the vendor, past transactions made with the company, data concerning its reliability, and other pertinent information of any sort that might be of value to the buyer. The purchasing department usually keeps a record of a commodity file, which is usually classified on the basis of types of products. The commodity files contain information about sources of supply from which products have been purchased in the past, the prices paid, a cross reference to the vendor files, and other pertinent information.

Criteria for evaluating suppliers.

Having a list of available vendors at hand, the purchasing officer must evaluate each supplier so that the list may be reduced to retain only the most likely sources of supply. In evaluating suppliers, there are several factors that must be considered. Those factors are related to the ability of suppliers to provide the desired quality, quantity, service and price.

Quality.

Quality of a product is viewed by the industrial buyer as that quality which will be suitable for the purpose for which it will be used. The best quality, therefore, is not necessarily the highest quality. Quality should always be judged on the basis of its suitability for the purchaser's needs rather than its perfection.

Reliability in delivery.

Reliability in delivery involves two elements, speed and certainty. Speed of delivery can be judged by some aspects such as the maintenance of adequate stocks near using centers and the use of the proper means

of transportation. Certainty of delivery, on the other hand, can be judged by some other aspects such as financial stability of a supplier, the adequacy of his equipment, his labor relations, and the competence of his technical and managerial employees.

The geographic location of a supplier might affect both speed and certainty of delivery. If a supplier is located at great distance from the buyer's plant, shipments from him may be subject to more risks of interruption and delays. However, the ability of a supplier to provide the desired quantity at the desired time must be considered in evaluating suppliers.

Service.

In industrial buying, service involves many elements each of which has its effect on dealing with a supplier. The most important types of service are technical, inspection and quality control systems, availability of spare parts, selling services, and promotional support.

Technical services involve help provided by a supplier's experts to buyers in solving technical problems that arise in connection with the use of his products. A supplier who has a group of experts and trained specialists to provide services and consultation to customers would be more acceptable than a supplier who does not have experts to provide such services.

The technological development of a supplier's activities and his interest in keeping with current methods are important factors that must be considered in evaluating technical service. Improvements and developments made by competitors make it necessary to the buyer to get better products from his suppliers.

The inspection methods and quality control standards maintained by a supplier are also important in evaluating service. A supplier who is careless about inspection will ship many items that might be rejected and returned because of their inconsistency with the quality standards and specifications. If quality-control standards maintained by such supplier are not satisfactory, imperfect items may not be discovered until after they have been incorporated into finished products, a matter which causes many problems to arise.

Availability of spare parts is an important factor in evaluating service. Many buyers prefer to do their own repairs for purchased machines. Availability of parts will enable such buyers to make repairs without delay, and therefore, they will avoid shutdown of machines and disruption of production. Moreover, if the purchased items are to be incorporated into finished products, availability of spare parts of such items in the market would be necessary for the success of the buyer's finished products.

Selling services are important and must be taken into account in evaluating service. The most important type of selling services is information provided by a supplier's salesmen on new products, new materials, and trade conditions.

Promotional support provided by a supplier is also an important factor in evaluating service. This is of a special importance in the case of dealing with a supplier of a new material that will be used in the production of a new product. A supplier may conduct a promotional campaign to contribute to the success of the end-product in the market. The buyer may, therefore, prefer to deal with a supplier who provide promotional services.

Price.

Price should not be considered by itself. Rather, it should be considered in the light of the factors of quality, delivery, and service. The purchasing agent should make sure first that the quality is adequate, delivery schedules will be met, and service is satisfactory; and only after these are assured, he should look to price as a deciding factor in rating suppliers.

In comparing prices purchasing agents have followed the practice of computing the relative costs of different materials as component parts of the finished product. They take into account variety of factors such as the amount of scrap or waste resulting from the use of the material, processing costs, and other characteristics that generate or minimize costs. The technique of making these comparisons are parts of the so called "value analysis". These techniques are used to enable the purchasing officer to determine for each industrial good the effect of its use on the final cost of the finished product. The marketing officer must also consider the impact of using materials bought on the quality and other features of the finished product according to the company's marketing strategy.

Vendor rating.

Some firms use rating procedures as an aid in selecting suppliers. These procedures are based on the actual performance of suppliers regarding quality, delivery, service, and price. While price can be determined objectively, difficulty arises in measuring the three other factors. However, some firms use rejection rate of a supplier's shipments as a measure of quality. Rejection rate is obtained by dividing the value of a supplier's materials which were rejected during a specific period of time by the value of the materials shipped during that period. Some formulas have been used to rate delivery and service.

Some companies inform their suppliers of their position on the rating scale. Suppliers are expected then to improve their performance in order to advance, or at least, to keep their position on the rating scale. The extensive use of rating systems by industrial buyers, however, depends to a large extent on the costs involved.

IV. Other Problems Related to Selection of Sources of Supply.

There are other matters related to the selection of sources of supply that must be considered by the purchasing officer. Two of these matters are discussed in this article. They are related to reciprocity policy and number of suppliers.

Reciprocity in purchasing refers to the practice of selecting suppliers who are customers of the buying firm. The term "trade relations" is usually used to refer to this practice since the term reciprocity has acquired unfavorable connotations. An increased use of reciprocity has been occurred in the chemical industry as a result of the intensified competitive pressures and increase in product diversification.

Some executives do not favor reciprocity for the following reasons:⁶

1. False markets can be created with companies that may later change their minds.
2. Deterioration of the firm's effort may occur as a result of false sales security.
3. Reducing competition in the market place may cause the technological development of the company to decrease.
4. Purchasing costs may be higher as a result of restricting competition.
5. Legal dangers may emerge as a result of restraint of trade situations.
6. New customers may be hard to find as a result of pre-established relationships with competitors.
7. Company reputation may be impaired because of bad publicity resulting from reciprocity.
8. Reciprocity does not follow the sound principles of buying and setting regarding criteria of quality, price, and service.

Reciprocity, however, has its supporters. Such supporters assert that both the buyer and the seller will benefit from selling to and buying from each other if loyalty and confidence exist on both sides. These supporters also believe that customers who are also suppliers will provide better service, since they understand the peculiar problems of the buying firm. Moreover, such supporters assert that reciprocity is a profitable way to expand a company's markets. For example, a battery manufacturer may intend to buy the brand of automobile that uses the firm's batteries. ⁷

Beside the common form of reciprocity which involved only two parties — the buyer and the seller — other complicated situations of reciprocity may be found. It may take the form of "three-way reciprocity." This form is illustrated by the situation of a construction firm which finds itself under pressure from the owner of the proposed building to buy from a particular materials supplier because that supplier happens to be a customer of the owner's product. Although the principles underlying these indirect reciprocal relationships are not largely different from two way reciprocity, indirect reciprocity received more criticism than the simpler form. Other complicated forms of reciprocity also exist. ⁸

6. Lamar Lee, Jr. and Donald W. Dobler, **Purchasing and Materials Management** (New York; McGraw-Hill, Inc., 1965), p. 79.

7. *Ibid*, p. 80.

8. See for example Reed Moyer, "Reciprocity: retrospect and prospect," **Journal of Marketing**, Vol. 34 (October, 1970), p. 48.

Reciprocity decisions concerning materials and components which will be part of a company's end-products are likely to affect its operations and competitive position more than decisions concerning materials and equipment which will be used in the company. Lower quality of materials or equipment may be used in production. Besides, delays in deliveries, poor technical service, or higher prices paid for such materials or components are factors which weaken the competitive future of the company and causes its profits to decline.

In situations where reciprocity relationships exist, careful record of sales, purchasing, and profits must be kept. Besides, careful analysis of costs and profits must be done to make sure that in any specific situation the sales advantages do not exceed purchasing losses as a result of the reciprocity relationships.

Reciprocity, however, is considered neither a sales problem nor a purchasing problem, rather it is a management problem. Management analysis of the total business situation is the deciding factor in this matter. If management believes that reciprocity policy would help the company expand its markets permanently, increase its profits, or contribute to the achievement of its long-term goals, then it should consider adopting this policy. If management believes that reciprocity would restrict the competitive forces and the firm's profit would be accordingly reduced, then it would not adopt this policy. In short, management should weigh such potential reciprocal relationships carefully and consider all matters of reciprocity as objectively as possible.

Number of Suppliers.

Some firms may prefer to have several sources of supply rather than one source. Sometimes, a firm may have to deal with a specific supplier. Such situation arises when a supplier has an item protected by patent. There are other factors which induce a firm to deal with a single supplier. Quantity discounts or lower shipping rates on carload quantities make it more economical to place orders to a single supplier. In other cases, total purchases may be too small to justify splitting the order among several suppliers since the per unit handling cost would be higher or because some suppliers would not accept small orders. Still in other cases expensive tools may be required for manufacturing goods purchased. The buyer may prefer to deal with a single supplier rather than paying extra money for such tools that he would have to provide if he chose several suppliers. Finally, dealing with one source of supply will induce the vendor to provide the buyer with better service and favor him over a buyer who splits his orders among several suppliers. This matter is of great importance in times of material shortage when competition in buying arises among buyers.

On the other hand, those who favor the policy of multiple sources of supply assert that splitting orders among several suppliers assures uninterrupted supply since the buyer would be more protected against such

occurrences as fire or strikes that might disrupt the operation of a single supplier's plant. Besides, this policy will encourage competition among suppliers, and will enable the buyers to obtain the best quality of materials at the best possible price. Supporters of multiple sources of supply argue further that such policy permits more flexibility of choice than in the case of dealing with a single supplier.

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