

## Topic One

### Introduction to Procurement

#### INTRODUCTION

This chapter introduces students to the core concepts of procurement. It is an overview of the procurement function and will expose students to aspects that will enable them appreciate the strategic importance of procurement management in today's competitive environment.

Each function in a firm, be it marketing, finance & accounting, human resource management or research & development has objectives that it aims at achieving in order to enable the firm attain its mission and vision. Below are the different functional areas in an organization

**Human resource.** Handles employee-related matters, such as recruitment, training, and compensation.

**Research and Development.** Focuses on innovation and developing new products or processes.

**Finance.** Manages financial resources, including budgeting, releasing funds.

**Procurement/Purchasing.** Acquisition of goods and services that the organization desires

**Warehousing and operations.** Receiving, storage and distribution of goods

**Production.** Oversees the manufacturing and quality control of goods/service

**Marketing and sales.** Focuses on promoting and selling products or services, including market research and advertising.

**Logistics.** Responsible for efficient movement process of goods /services to the final consumer

**Accounts.** Responsible for recording and reporting cash flow transactions of an organization

#### Definition of Procurement

Procurement is the process of acquiring goods, works and services. There are different ways in which needed items can be acquired by a buyer or buying firm. These forms of purchasing include leasing, renting, contracting, purchasing. Purchasing is a form of procurement.

According to Kenneth Lyons (2003), the 5 RIGHTS OF PROCUREMENT is "To obtain materials of the right quality in the right quantity from the right source, delivered to the right place at the right price". This introduces the concept of the "five rights" in procurement (also known as

the 5 Rs in procurement). This definition perfectly describes what we would like to achieve when we go out to purchase a needed item.

### **Distinction Between Procurement and Purchasing**

Procurement is somewhat a broader term than purchasing. It includes all activities required in order to get the product from the supplier to its final destination.

It encompasses *the purchasing function, stores management, transportation decisions, and inspection of incoming items, quality control and assurance*

Procurement involves the process of *selecting vendors, establishing payment terms, strategic vetting, the negotiation of contracts and actual purchasing of goods.*

Procurement is, essentially, the overarching or umbrella term within which purchasing can be found.

Purchasing is a subset of procurement. Purchasing generally refers simply to buying goods or services.

Purchasing can usually be described as the transactional function of procurement for goods or services.

Purchasing is a process within the overarching procurement process, both procurement and purchasing are often used interchangeably.

### **Procurement Situations (procurement tactics, 2025)**

- **New Buy:**

A purchase situation where the organization is buying a product or service for the first time, often requiring extensive research and evaluation of potential suppliers.

- **Modified Rebuy:**

A purchase situation where the organization is buying a product or service it has purchased before, but with some changes to the product specifications, price, or supplier.

- **Straight Rebuy:**

A routine purchase of an item that the organization buys frequently, often with established suppliers and processes.

## **PROCUREMENT PROCESS**

In order for one to obtain needed items, a process has to be undertaken; this process has a number of stages and may vary depending on the firm or even sector that is whether it is private or public.

### **Private versus Public Procurement**

Public procurement is different from private procurement, because in public procurement the economic results must be measured against more complex and long-term criteria. Furthermore, public procurement must be transacted with other considerations in mind, besides the economy. These considerations include accountability, non-discrimination among potential suppliers and respect for international obligations. For these reasons, public procurement is subjected in all countries to enacted regulations, in order to protect the public interests. It is worth noting that unlike private procurement, public procurement is a business process within a political system and has therefore significant consideration of integrity, accountability, national interest and effectiveness.

**Note: The public procurement process will be covered in detail in the public procurement course unit.**

### **Stages of the Procurement**

According to Van Weele (2005)<sup>1</sup>,

#### **1.Needs Identification**

The purchasing cycle begins with the identification of a need (i.e. a requirement).

#### **2.Specification**

is stating in detail what is required in order to meet the need. It should be clearly noted that specification cannot take place unless need identification has been done. So, before one embarks on specification, he / she should clearly identify what the need at hand is. Specification involves stating the characteristics / qualities or attributes of the item that is needed. This stage is very vital because it does provide the basis for all that will be done during the purchasing process, for

---

Arjan. J. Van Weele, (2005), **Purchasing & Supply Chain Management – Analysis, Strategy, Planning and Practice**, (Fourth Edition), Thomson Learning

instance suppliers will be selected basing on their ability to provide the supplied item. If mistakes are made at this stage, they will be carried on throughout the whole process and sometimes it may be too late to make changes and losses will be made. Take an instance where one would like to buy water but when contacting the supplier, he or she says she would like something for drinking. The supplier is at liberty to bring juice (fresh or preserved), alcohol, wine, soda, etc. In this case, the supplier is not in the wrong but the fault is that of the buyer due to failure to clearly state what was desired. The result of this stage is known as a “programme of requirements”, which lists all requirements that a supplier has to meet in the offer. They are not only requirements for goods and services to be purchased but may also include requirements for the relationship with the supplier, additional services to be provided, like maintenance and supply of spare parts and other conditions.

When the programme of requirements is not complete or incorrect, it is not always easy to find the suitable supplier. Many times, firms or people over – specify due to fear of getting a wrong offer – but this also makes it hard to find the perfect supplier sometimes.

### **Methods of specification**

There are several ways in which needed items can be specified. These include:

- (a) Brand name – for instance, when buying toothpaste, you would specific by brand names by saying “I would like to buy Colgate, Close – up, Aqua – fresh”, etc
- (b) Dimensions – using measures in meters, inches, yards, e.t.c to describe what is needed. Uses of sizes like small, medium or large, ½ inch also apply in this case. This specification can be used in combination with another method of specification, for example, “medium sized Colgate tube”.
- (c) Physical or chemical properties – specifying items by physical properties like colour, size, height, weight, e.t.c or chemical properties like percentages of minerals or food content like desiring to drink mineral water with a certain percentage of calcium. For physical properties, take an instance where one is buying printing paper, it can be described as “white A4 or A5 paper” (A4, A5, are standard sizes of paper on the market). Beds are in sizes like king and queen size.

- (d) Market grade – some products have market grades, like maize flour in Uganda has grades like super and normal. This applies to rice as well – it has market grades. So one would specify the type of maize flour by saying “I would like super posho”.
- (e) Methods / materials / Country of manufacture – some items are specified basing on aspects of manufacture like methods, materials and country. For instance, some people prefer hand – made carpets (method of manufacture); American or British items (country of manufacture / origin); or cotton shirts / blouses (materials of manufacture).
- (f) Sketch diagram – in this case, a drawing (sketch) of the desired item is made and presented to the supplier / seller so that he/ she is able to gauge what is desired by the customer. Sketches are common today when describing the fashion of clothing that one would like a tailor to make for them. Sketches may also be used to specify items like furniture, shoes, e.t.c
- (g) Function / use – items are specified basing on the function for which they are required. For example, if one wanted shoes or sandals, the specification in this case would be “something to protect or cover my feet as I walk”. In this case, options range from slippers to gum boots as long as what is available can cover the feet or protect them. If someone wanted a drink, the specification can be “something that I can drink”. Options in this case are endless; the person may be provided with wine, alcohol, water, juice, e.t.c as long as what is provided can be drunk. The danger of specifying by function is that the provider may be at a loss on hat exactly to give the customer as the options of what can be provided are very many.
- (h) Samples – a sample of what is required is sent to supplier / provider. For instance, if a firm wanted to buy a certain type of pens, they can send one type of the desired pen to the supplier and ask him / her to deliver that type of pen.

The role of drawing up specification may be undertaken by individuals, procurement teams, procurement officers and user departments depending on the organization and the sector (whether private or public).

- When making purchases, buyers have the option of using standard or customized specifications. Customized specifications require that items are made to suit the needs of the customer – this is common when people want their clothes tailored, usually specifications are customized. On the other hand, when using standard specification, we rely on specifications that are already available and are known on the market, for example the sizes of Colgate toothpaste are standard – small, medium and large.

### **3.Source Identification and evaluation**

After defining what exactly is needed, the next stage is to establish where it will be obtained from.

### **4.Selecting**

After defining what exactly is needed, the next stage is to establish where it will be obtained from. This leads us to the next stage, which is that of selecting a supplier. Selection is done in two phases, first of all selecting all suppliers whose offers match the needs of the buyer and secondly, choosing the supplier whose offer best meets the need at hand. Before choosing a supplier it is important that one defines what aspects will be based on when selecting suppliers (supplier selection criteria). Supplier selection criteria will be covered in a later chapter in this reader. The supplier selection criteria are a result of the list of requirements in one's specification (programme of requirements). In some cases, when making offers, suppliers will also submit proposals – it is also very vital to evaluate the proposals. This also calls for proposal evaluation criteria, in other words, what will be based on to choose the best proposal? At this stage, we have two criteria – supplier evaluation and proposal evaluation.

The supplier criteria all relate to the supplier and its organisation like size, geographical location, and experience, etc while the proposal criteria all relate to the content of the proposal, such as quality of the offer and price. When the supplier has been chosen, parties will enter into negotiations, leading to a contract if negotiations have been successful.

### **5.Contracting**

This is a contract signed between the supplying party and buying party. It is vital that the contract is drawn by a person with legal knowledge to avoid mistakes. The contract should include aspects

of the programme of requirements, terms and conditions, agreed pricing, e.t.c. The terms and conditions are a major subject of discussion during the contracting stage. Negotiations will usually concern legal details that are crucial to closing the deal. Pricing is a result of the offer from the supplier. The contract contains all agreements related to the deal - not only on what is to be supplied, but also the way in which logistics, after sales and the financial part are dealt with are described.

Once a contract has been concluded, its content is to be communicated to the parties in the organization that will be affected by the new contract. These parties have probably already been consulted during the specification and selection stages. Parties may include, but are not limited to:

- The legal department, which most likely has been involved in drawing up the contract and discussing it with the supplier, will file the contract and maybe assigned the task of monitoring the contract's validity in terms of duration and correctness.
- Accounts payable has to be informed so that they set up a new supplier in the financial system and arrangements on payments can also be made.
- End users of the new product or service may need information, a demonstrator or a course work with it.
- Depending on the kind of product or service purchased logistic services, technical maintenance and facility management.

## **6. Ordering**

Ordering is the actual requesting of a delivery. An order can be a one – off, for example because it is part of an extensive purchasing process for a large investment. In that case the ordering process coincides with concluding the contract and does not need any special attention. More often the ordering is frequently repeated, for example the ordering of supplies for the canteen or of laptops for new employees.

In most organisations an order is preceded by a requisition that is initiated by the end user and has to be approved before an order can be issued. The process of initiating a requisition, approving it and raising an order can be more time consuming than necessary. E-Procurement solutions largely

focus on this part of the purchasing process to reduce administrative workload, decrease cycle times and hence save money.

The design of the ordering process, including its steps and documents should not be underestimated. Mistakes in e.g. reference numbers; amounts, supplier or client details can cause delays and confusion, creating unnecessary costs. Always make sure it is clear what is ordered, when it should be delivered, to whom and where. Such details are usually agreed upon with suppliers and laid down in the contract.

### **7. Receipt and Inspection of Purchases**

Once the supplier delivers the product, the buyer accepts or rejects the items. Acceptance of the items obligates the company to pay for them.

### **8. Invoice Approval and Payment**

Three documents must match when an invoice requests payment – the invoice itself, the receiving document and the original purchase order.

**9. Records Maintenance.** In the case of audits, the company must maintain proper records

## **Classification of Purchased Items**

After grasping the definition of purchasing, it is important to know the various categories of items that are purchased in firms on a day to day basis.

Firms purchase items in the categories of goods, services and works. Goods are tangible while services are intangible.

### **Item Categories**

In general, purchased goods fall in the categories mentioned below:

- **Raw materials** - These are materials, which have undergone no transformation and serve as the basic materials for a production process.
- **Supplementary materials** - These are materials, which are not absorbed physically into the end product they are used or consumed during the production process. Examples of this type are lubricating oil, cooling water, polishing materials and industrial gases.



- **Semi – manufactured products** - These products have been already processed once or more and they will be processed further at a later stage. They are physically present in the end products. Examples are steel plates, rolled wire and plastic foils.
- **Components** - These are manufactured goods, which will not undergo additional physical changes but will be incorporated and are built into the end product. Examples include headlight units, lamps, batteries, and engine parts. A distinction can be made between specific, customised and standard components. Specific and customised components are produced according to the design or specification of the customer while standard components are produced according to specification of the supplier or industry norm.
- **Finished or trade products** - These include all products, which are purchased to be sold. Items sold by retailers, wholesalers and stores fall in this category.
- **Investment goods or capital equipment** - These are products which are not consumed immediately but whose value is depreciated over a period of time. Investment goods can be machines used in production, computers and buildings.
- **Maintenance, repair and operating materials (MRO Items)** - These products sometimes, called indirect materials or consumable items are materials, which are necessary for keeping the organisation running in general. Examples include office supplies, cleaning materials, copy paper but also maintenance materials and spare parts.

#### **OR the KRALJIC MODEL???**

- **Strategic Products**

These are high tech, high volume products, which are often supplied at customer specification. Only one source of supply is available, which cannot be changed in the short term without incurring considerable costs.

- **Leverage products**

These are products that can be obtained from various suppliers at standard quality grades. They represent a relatively large share of the end product's cost price and are bought at large volumes. A small change in price has a relatively strong effect on the cost price of the end product.

- **Routine products**

These products usually have a small value per unit. In addition, many alternative suppliers can be found. From a purchasing point of view, these items cause only few technical or commercial problems

- **Bottleneck Products**

These items represent a relatively limited value in terms of money but they are vulnerable with regard to supply. They can only be obtained from one supplier. Examples are catalytic products for chemical industry, and natural flavorings and spare parts for rare equipment

## **Documents Used in the Procurement Process**

- **Requisition note**

This is created by operations or user department for the required item. And what item is needed. It also helps a buyer to know whether it's a re - buy or new buy.

- **Enquiry or Requests for Quotations (RFQs)**

This is a request for information or quotations sent to potential suppliers. This is done to ascertain who is willing and able to supply and at what price and terms.

- **Quotations**

These are expressions of interest or proposals received from a supplier.

- **Purchase order**

Following negotiations or clarifications a purchase order is raised and copies sent to interested parties. This is a legal offer or acceptance and the supplier knows that he or she will be paid by the organization.

- **Advice note**

This is sent to a buyer informing him that the goods have been dispatched or are ready for delivery such that he gets ready to receive them.

- **Delivery note**

The supplier on the delivery of the consignment provides this. This allows the buyers goods receiving section to check that the physical delivery matches with the documentation

- **Goods received note**

This is a document that is sent to the purchasing department after the goods have been received and checked and have been found to be in good order. The purchasing department will then inform the finance that the supplier should be paid on receipt on the invoice

- **Goods return note**

This is a document issued by the goods receiving section if goods are not found to be in good condition

- **Invoice**

This is a document sent by the supplier after delivery has taken place. It requests the buying company to pay the suppliers for what was delivered

- **Order acknowledgment note**

This is a document sent by the supplier informing the buyer that he is willing to conform to the delivery dates and terms. This is done to let the buyer know that the supplier understands and accepts the order.

## **ROLES OF THE PROCUREMENT FUNCTION IN AN ORGANIZATION**

- To supply the organisation with a steady flow of materials and services to meet its needs
- To ensure continuity of supply by maintaining effective relationships with existing sources and developing other sources of supply either as alternatives or to meet emerging or planned needs
- To buy efficiently and wisely, obtaining by ethical means the best value for every coin spent
- To manage inventory so as to give the best possible service to users at lowest costs
- To maintain sound co-operative relationship with other departments, providing information and advice as necessary to ensure the effective operation of the organisation as a whole
- To develop staff, policies, procedures and organisation to ensure the achievement of set objectives

Other specific roles include:

- To select the best suppliers in the market
- Protect the company's cost structure
- Monitor supply market trends
- Negotiate effectively in order to work with suppliers who will seek mutual benefit through economically superior performance.

## **SIGNIFICANCE (IMPORTANCE) OF THE PROCUREMENT FUNCTION**

Purchasing policies fundamentally contribute to business success in several ways:

- Purchasing policies can improve sales margins through realising substantial costs savings. Every dollar not spent is a dollar extra profit.
- Suppliers may contribute significantly to the company's innovation processes
- Through purchasing quality materials, purchasing contributes to the quality of the final goods and services produced.
- Through purchasing strategies like outsourcing, a firm is able to reduce on capital employed, fixed costs and focus on core business activities, increasing competitiveness.
- Purchasing helps firms realise their strategies and achieve competitive advantages over their competitors.

## **PRINCIPLES OF PROCUREMENT**

- Non discrimination
- Transparency
- Accountability
- Fairness and objectivity
- Competition
- Economy and efficiency
- Ethics
- Preference and reservation
- Public accessibility