

Analysis of International procurement environment and supply markets

Environmental Analysis: Definition and Rationale.

International sourcing involves buying from suppliers outside the firm's country of manufacture. It requires purchasing personnel to view the entire world as a potential source for raw materials, components, services and finished goods.

But before any firm can venture into international procurement it will have to understand the international procurement environment and the risks associated with it. Environmental risk refers to risks associated with the economic, political, cultural, natural, and infrastructure aspects of various countries of the world.

Environmental analysis is the process of monitoring the organisational environment to identify both present and future threats and opportunities that may influence the firm's ability to reach its goals. Organisational environment is a set of all factors both inside and outside the organisation that can affect progress towards attaining those goals.

Environmental Analysis is necessary on account of the general systems theory of organisations. According to this theory, modern organisations are open systems and therefore they are influenced by the environment. It is up to the managers to ensure that this influence is channelled in a positive direction and contributes to organisational success.

Importance of Environmental Analysis in international procurement

- There is need to understand where to source from, if the materials needed are readily available.
- Service Performance
- Need for international logistics management.
- Cultural and legal difference in international procurement
- Volatile economic and Political environment in international procurement
- Fluctuation of Currency exchange rate in international procurement
- Different standards and regulations in international procurement
- Supplier selection complexity in international procurement

Other reasons may include;

- Environmental factors are the prime influences of strategic change.
- Monitoring environmental developments gives strategists time to anticipate opportunities and plan to take optional responses to these opportunities,
- It helps strategists develop early warning system to prevent threats or develop strategies which can turn a threat into a firm's advantage.
- Need to determine what environmental factors present threats to the company's current strategy and which factors present opportunities,
- Successful environmental analysis is essential for effective performance of the firm.

There are several tools that used to analyse the environment when conducting international procurement transactions. Among these are;

- ❖ PESTLE Analysis
- ❖ Kraljic Model
- ❖ Porters Five Forces Model
- ❖ SWOT Analysis

PESTLE ANALYSIS

This is a model that looks at the political, economic, social and technological issues that prevails in different countries and will affect the procurement activities across borders. It is very crucial a procurement officer to first analyse the situation prevailing in those countries where he intends to transact with in terms of:

Political Component

The political aspects are elements that relate to governmental affairs. They cover areas like political stability, political risk and security of business operations. Political ideology, e.g. Multi vs single party, socialist vs capitalist. A socialist system, through central planning, may want to impose restrictions in business operations while capitalist would prefer the opposite.

The legal components constitute legislation by government, covering employment law, Land law, Tax law (including corporation tax, PAYE NSSF and VAT). It may also involve imposition of embargos, licences, tax holidays or exemptions.

Other political aspects to consider include

- Government type and stability
- Freedom of the press, rule of law and levels of bureaucracy and corruption
- Regulation and de-regulation trends
- Social and employment legislation
- Tax policy, and trade and tariff controls
- Environmental and consumer-protection legislation

Economic Component

This involves three factors: the nature of the economy, structure of the economy and organisation of financial markets.

❖ Nature of the Economy

This concerns the ownership of means of production. Whether the economy is public sector driven or private sector driven or if it is mixed economy. It includes the aspects of privatisation and liberalisation

❖ Structure of the economy

This refers to whether the economy is agro-based or manufacturing, industrialised. Whether it is capital or labour intensive. It gives the level of economic activity in the country.

❖ Organisation of Financial Markets

This is crucial for financing of business units for short and long term activities. The firm should look at capital and money markets and their level of development.

Income per capita of the population, the income distribution, average income per family and disposable income of the population are indicators of the consumption power of the market.

Trends in Interest rates, relative Inflation rates in domestic and overseas markets and Government spending affect prices and performance of economic activities.

Other issues to consider may include;

- Current and projected economic growth, inflation and interest rates
- Unemployment and supply of labor
- Labor costs
- Levels of disposable income and income distribution
- Likely impact of technological or other changes on the economy
- Likely changes in the economic environment

Social and cultural factors

This describes the characteristics of the society in which the organisation operates. They include the following;

- Population: The growth or decline in a national population and regional populations.
- Age: Changes of age distribution of the population eg in UK there is an increasing proportion of population over retirement age while in the developing world the increasing trend is for young people.
- Geography: Concentration of population in certain geographical areas.
- Employment: Workforce with core employees and peripheral employees on part-time or temporary employment
- Wealth: Rising standards of living lead to increased demand for certain types of consumer goods. This is why developing countries are attractive as markets.
- Culture encompasses the sum total of beliefs, knowledge, attitudes of mind and customs to which people are exposed in social conditioning. Culture refers to:
 - Beliefs and values: Beliefs is what we feel is the case on the basis of objective or subjective information (e.g. people can believe the world is flat or round). Values are beliefs which are relatively enduring, relatively general and fairly widely accepted as a guide to cultural behaviour. Beliefs shape attitudes and create tendencies for individuals and societies to behave in certain ways.
 - Customs: Modes of behaviour which represent culturally accepted ways of behaving in response to given situations.
 - Other aspects of culture are education levels. This determines the people's literacy and levels of understanding. Other elements of culture are religion and superstitions.

Technological Components:

This includes new approaches to producing goods and services.

- Level of technology in the international market and the rate at which it is changing. This should be compared with that in the domestic market.
- Production methods used by competitors.
- The degree to which a firm can imitate the technology of competitors.
- Relative cost of Technology and labour.
- Maturity of technology, competing technological developments, research funding, technology legislation, new discoveries
- Information technology, internet, global and local communications
- Technology access, licensing, patents, potential innovation, replacement technology/solutions, inventions, research, intellectual property issues, advances in manufacturing
- Transportation, energy uses/sources/fuels, associated/dependent technologies, rates of obsolescence, waste removal/recycling

Legal:

How local, national and global legislation affects international procurement

- ❑ current home market legislation, future legislation
- ❑ European/international legislation
- ❑ regulatory bodies and processes
- ❑ environmental regulations, employment law, consumer protection
- ❑ industry-specific regulations, competitive regulations

Environmental:

- ❑ Ecological
- ❑ environmental issues, environmental regulations
- ❑ customer values, market values, stakeholder/ investor values
- ❑ management style, staff attitudes, organizational culture, staff engagement

Michael Porter's Five Competitive Forces Model

Porter's Five Forces of Competitive Position Analysis were developed in 1979 by Michael E Porter of Harvard Business School as a simple framework for assessing and evaluating the competitive strength and position of a business organisation.

This theory is based on the concept that there are five forces that determine the competitive intensity and attractiveness of a market. Porter's five forces help to identify where power lies in a business situation. This is useful both in understanding the strength of an organisation's current competitive position, and the strength of a position that an organisation may look to move into.

Strategic analysts often use Porter's five forces to understand whether new products or services are potentially profitable. By understanding where power lies, the theory can also be used to identify areas of strength, to improve weaknesses and to avoid mistakes.

Porter identified five critical forces determining the profitability of an industry.

1. Bargaining power of suppliers
2. Bargaining power of the buyers or customers

3. Threat of New entrants
4. Threat of substitute products of services
5. Rivalry among existing companies.



Porter's Five Competitive Forces Model

Porter argued that an industry with strong competitive forces in total (current competitors jockeying for positions, entry to the industry is easy, substitute products pose a real threat etc) had the worst prospects of long-run profitability.

On the other hand high average rates of return in an industry would be a result of high entry barriers, suppliers and buyers with little bargaining power, the absence of substitute products or services and stable rivalry between competitors. The weaker the forces are collectively the greater the opportunity for superior performance.

Within this framework the strategist is seeking a position in the industry where his or her company can best defend itself against these forces or can influence them in its favour.

Threat of New Entrants

This force examines how easy or difficult it is for competitors to join the marketplace in the industry being examined. The easier it is for a competitor to join the marketplace, the greater the risk of a business's market share being depleted.

The following are the sources of major barriers to entry:

- Economies of scale – an incoming firm should have large scale operations otherwise it will suffer a cost disadvantage.
- Product Differentiation – An already established brand will force new entrants to spend heavily in a bid to win customers whose loyalty is already with the existing firms.
- Capital Requirements – High capital requirements will discourage new entrants.
- Access to distribution channels- The incumbents may have an advantage over the new entrant in terms of either ownership of the existing channels or their availability.
- Government Policy – Government may create barriers to entry through licensing and legislation.
- Expected Retaliation - A firm's decision to enter an industry may be influenced by the likely reaction of the existing firms.

Bargaining power of Buyers (Customers)

This force looks at the power of the consumer to affect pricing and quality. Consumers have power when there aren't many of them, but lots of sellers, as well as when it is easy to switch from one business's products or services to another. Buying power is low when consumers purchase products in small amounts and the seller's product is very different from any of its competitors.

The following characteristics are considered powerful

- Purchasing high volumes
- Existence of alternatives
- Purchase products which constitute a high proportion of their costs
- The purchased products do not save them money
- Buyers can make credible threats of backward integration
- The product is not important to the quality of the buyers product or service

Threat from substitute products or services

This force studies how easy it is for consumers to switch from a business's product or service to that of a competitor. It looks at how many competitors there are, how their prices and quality compare to the business being examined and how much of a profit those competitors are earning, which would determine if they have the ability to lower their costs even more. The threat of substitutes are informed by switching costs,

- The relative price of substitutes
- Performance of substitutes (quality, assurance, durability)
- Cost of switching from one product to another.
- Price-performance trade-offs.

Bargaining power of suppliers

This force analyzes how much power a business's supplier has and how much control it has over the potential to raise its prices, which, in turn, would lower a business's profitability. In addition, it looks at the number of suppliers available: The fewer there are, the more power they have. Businesses are in a better position when there are a multitude of suppliers. Sources of supplier power also include the switching costs of firms in the industry, the presence of available substitutes, and the supply purchase cost relative to substitutes. Determinants of bargaining power of suppliers include;

- Relatively large compared to buyers
- Have unique differentiated product
- Have built up high switching costs
- Enjoy absence of substitute products
- Can make credible threats of forward integration
- The industry is not an important customer of the supplier group

Rivalry within the industry

This force examines how intense the competition currently is in the marketplace, which is determined by the number of existing competitors and what each is capable of doing. Rivalry competition is high when there are just a few businesses equally selling a product or service, when the industry is growing and when consumers can easily switch to a competitors offering for little cost. When rivalry competition is high, advertising and price wars can ensue, which can hurt a business's bottom line.

Intense rivalry is characterised by:

- Numerous equally sized and powerful competitors
- Slow growth of the industry
- No differentiation
- No switching costs
- High fixed costs
- Perishable products
- Capacity that has to expanded in large increments
- High exit barriers
- Overcapacity
- Rivals who differ strongly (strategies, origins, personalities, and ideas on how to compete)

Kraljic's (1983) Purchasing Product Portfolio-Approach

The Kraljic Portfolio Purchasing Model was created by Peter Kraljic and it first appeared in the Harvard Business Review in 1983. Despite its age, it's a popular and useful model used in companies worldwide.

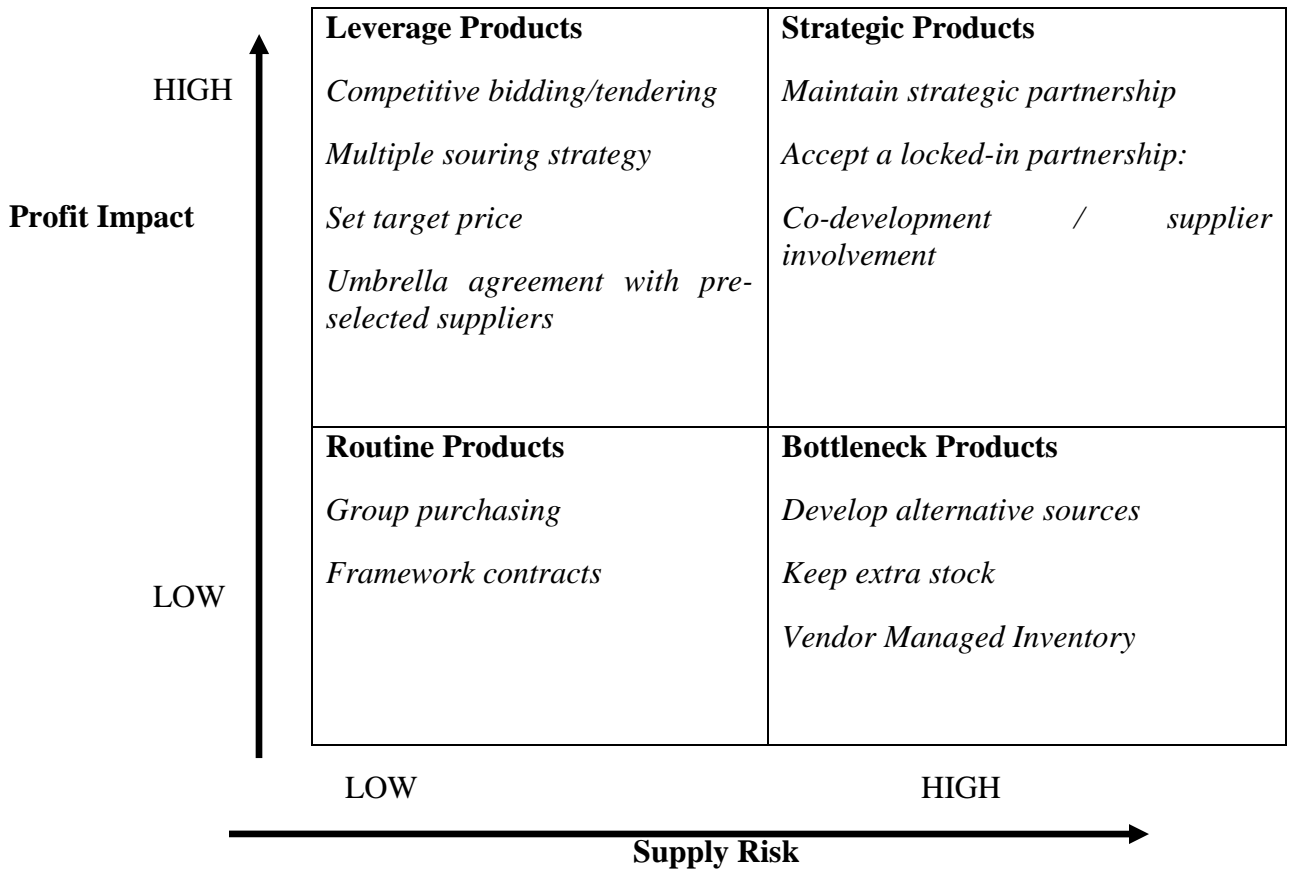
Its purpose is to help purchasers maximize supply security and reduce costs, by making the most of their purchasing power. In doing so, procurement moves from being a transactional activity to a strategic activity – because, as Kraljic said, "purchasing must become supply management."

Kraljic model helps refine the above questions in purchasing strategies. This approach of purchasing turnover and supplier base are analysed on the basis of two variables:

- Purchasing impact on bottom line to the company. The profit impact of a given supply item is measured against criteria such as cost of materials, total costs, volume growth. The higher the volume or amount of money involved, the higher the financial impact of purchasing on the bottom line.
- The Supply risk. This measures against criteria such as short term and long term product availability, number of potential suppliers available, cost of changing a supplier, supply market structure, geographic distance, inventory risks and available substitutes. Sourcing a product from just one supplier without an alternative source of supply, in general represent a high supply risk. Supply risk is low when a (standard) product can be sourced from many suppliers, and switching costs are low.

Kraljic model of two dimensional matrix with four quadrants are used to explain the above variables.

Purchasing Product Portfolio



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. This type of product represents a high cost of company’s end product. Examples are gear boxes for automobile manufacturers, company ERP systems. Communication between the buyer and supplier are usually intensive and the relationship can either be Buyer dominated or Supplier dominated.

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. Here buyers exert aggressive sourcing and tendering among a small sample of prequalified Suppliers. Examples of such products are raw materials and standard semi manufactured commodities.

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. Here the supplier is dominant in the relationship with the buyer, which may result in high prices, long delivery time, bad service and severe cost consequences.

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.

SWOT ANALYSIS

SWOT looks at the strength, weakness, opportunity and threats that may affect the procurement process at international level.

On the one hand, the audit includes a planning input to a systematic evaluation of both external (opportunities and threats) and internal (firm strengths and weaknesses) environments. On the other hand, the information about competitors and customers (e.g. market intelligence) is collected to assist senior managers in making resource commitments, which are intended to provide options for the firm to exercise in order to maximize the fit between its capabilities and future opportunities, Novicevic, *et al* (2004).

Therefore, Procurement officers need to analyse those dimensions of their suppliers as well as their own in order to come up with a strategy the will lead to a successful procurement.

This should be looked in terms of the buyer's strength and weakness in relation to the opportunities and threats from their suppliers. By doing the analysis will help buyers come up with a strategy that will lead to value for money procurement.

Strengths:

- High Ethical Standards
- Regular demand
- High purchasing power
- Employee Training

Weaknesses:

- Focus on Internal Customer Service
- Lack of skills in international procurement
- Strict budget
- Bad reputation
- Purchase of highly sensitive materials
- Irregular demand

Threats:

- Unsecured Funding
- Political Changes
- Government Regulations
- Bad reputation of the supplier
- Supplier running out of business

- Competition for the materials
- Unfavorable exchange rates

Opportunities:

- Supplier development
- Outsourcing
- New supplier coming into business
- Alternative materials
- Partnerships and alliances
- Supplier development
- Improve Business-to-Consumer Technology
- Implement Business-to-Business Technology
- Establish Performance Measures and Initiatives

LOGISTICS PERFORMANCE INDEX

The Logistics Performance Index is an interactive benchmarking tool created to help countries identify the challenges and opportunities they face in their performance on trade logistics and what they can do to improve their performance. The LPI 2014 allows for comparisons across 160 countries. The LPI is based on a worldwide survey of operators on the ground (global freight forwarders and express carriers), providing feedback on the logistics “friendliness” of the countries in which they operate and those with which they trade. They combine in-depth knowledge of the countries in which they operate with informed qualitative assessments of other countries where they trade and experience of global logistics environment. Feedback from operators is supplemented with quantitative data on the performance of key components of the logistics chain in the country of work.

The LPI consists therefore of both qualitative and quantitative measures and helps build profiles of logistics friendliness for these countries. It measures performance along the logistics supply chain within a country and offers two different perspectives: international and domestic.

International LPI

Provides qualitative evaluations of a country in six areas by its trading partners—logistics professionals working outside the country.

Domestic LPI

Provides both qualitative and quantitative assessments of a country by logistics professionals working inside it. It includes detailed information on the logistics environment, core logistics processes, institutions, and performance time and cost data. The Logistics Performance Index (LPI) is a global benchmarking tool developed by the World Bank to measure the efficiency.

Components of the LPI;

- Customs Efficiency.
- Infrastructure Quality
- International Shipments
- Logistics Competence
- Tracking and tracing
- Timeliness