

Buy Right

Purchasing

Objectives:

- A** Describe the role of purchasing in business.
- B** Discuss the purchasing process used by businesses.



1375 King Avenue, P.O. Box 12279, Columbus, Ohio 43212-0279

Ph: (614) 486-6708 Fax: (614) 486-1819

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Keisha loves to shop and spends nearly every spare minute at the mall. But she doesn't have a lot of money—just the cash that she earns from occasional babysitting jobs. To make her money last longer, Keisha is always on the lookout for good deals.

For example, when she needed a pair of shoes for prom, she checked the selection at several shoe stores. She searched for shoes in the size she needed, the style she wanted, and, finally, the price that was best, given the brand of the shoes. By doing some research, she was able to find the best deal on prom shoes at the mall.

"If only I could find a way to make shopping a full-time job!" Keisha often says to herself. In fact, she can! Professional shopping, called purchasing in the business world, is a viable career choice for individuals who enjoy finding good values. Read on to learn more about the importance of purchasing, its role in business, and the purchasing process that businesses use.



Purchasing's Pivotal Part

On the surface, the **purchasing** function in business is pretty easy to understand. A purchasing specialist in business buys goods and services for his/her company, just as you buy things for yourself. But what exactly does a purchasing specialist buy? That depends on the business and its needs. A purchasing specialist—sometimes called a purchasing agent, purchasing manager, procurement manager, or buyer—might buy raw materials, parts, equipment, finished products, supplies, furniture, uniforms, or any number of services.

Let's think about Brad, the purchasing specialist for Roma's Pizza Parlor. What does Brad need to buy for the restaurant? He needs to buy pizza ingredients, such as flour, yeast, salt, pizza sauce, cheese, meats, and toppings, right? What other less obvious supplies or equipment does the pizza parlor need to be successful? The restaurant needs napkins, plates, glasses, silverware, cleaning supplies, pizza ovens, and pizza pans, among other things. In short, Brad has a very long shopping list!

- *What does a purchasing specialist buy? That depends on the business and its needs. The purchasing specialist for a pizza parlor needs to buy pizza ingredients.*



Types of Purchasing

In the corporate world, there are three types of purchasing—buying for resale, buying for transformation, and buying for business use. The kind of purchasing that a company does is based on the nature of the business.

Buying for resale. When a business purchases items for resale, it buys things to sell to other businesses or consumers. Two types of businesses buy items for resale: **wholesalers** and **retailers**. Wholesale buyers purchase goods from manufacturers and other wholesalers to sell to retailers and businesses. Retail buyers, on the other hand, purchase goods from wholesalers or manufacturers to resell to consumers. Whether wholesalers or retailers, buyers must understand trends and know what will appeal to their customers. In many cases, it's up to the buyers to purchase what they think their companies will resell successfully.



▲ *When a business purchases items for resale, it buys things to sell to other businesses or consumers.*

One company that specializes in buying for resale is Half Price Books, the largest privately owned new and used bookstore chain in the United States. Half Price Books employs numerous buyers who specialize in retail purchasing. These retail buyers conduct business with wholesalers and publishers around the world to purchase truckloads of new books, toys, and other merchandise to resell to their store customers. Other Half Price Books buyers focus on wholesale buying. These purchasing specialists purchase books to resell to other bookstore chains and retail businesses through the company's wholesale division, The Texas Bookman. Finally, there are buyers on staff at each Half Price Books store to purchase used books, CDs, and DVDs from customers. These items are typically resold in the stores.

Buying for transformation. To transform something means to change its shape or appearance. Purchasing specialists who buy items for transformation purchase raw materials and components that will be converted into finished products through some type of production process. These purchasing specialists, also called industrial buyers, typically work for manufacturing companies.

To read more about industrial buyers and what they do, check out this article from WiseGEEK, "What Does an Industrial Buyer Do?": <http://www.wisegeek.com/what-does-an-industrial-buyer-do.htm>.



▲ *Purchasing specialists can buy raw materials and components that will be transformed into finished products. A purchasing specialist might buy lumber to turn into furniture.*

Industrial buyers need to be involved in production planning if they are to be successful at their jobs. Before an industrial buyer can place an order for raw materials or components, s/he needs to know the following:

- The finished products the company is planning to produce
- The quantity of goods the company is planning to produce
- The raw materials or components needed to produce the finished products
- The process of converting the raw materials or components into finished products
- When the raw materials or components are needed
- Whether the company has room to store the raw materials or components until they are used

Many industrial buyers are involved in the production of Apple's iPhone, the highly popular smartphone that you and many of your classmates might have. Rather than making the iPhones completely from scratch, the company purchases the components and parts that will ultimately become the iPhone from a variety of suppliers. The iPhone's chips come from Samsung, its camera from Sony, its flash memory from Toshiba, and its many other components from numerous sources.



Photo of iPhone by Micky Aldridge-<https://www.flickr.com/photos/gsi-r/5213626727/>

▲ *The many components and parts that become the iPhone come from a wide variety of suppliers.*

In fact, Apple does not even assemble the iPhone's parts itself; instead, the company hires outside manufacturers (often in China) to produce the final product. That means that when you purchase an iPhone from Apple, your money goes in a lot of different directions—to Apple, to the manufacturers in China, and to suppliers in Japan, the United States, Taiwan, South Korea, and elsewhere throughout the world. And chances are industrial buyers brought the components from all of these different companies together!

You can read more about all that goes into the making of an iPhone by checking out this article and infographic from Alex Hillsberg, "How and Where iPhone Is Made: A Surprising Report on How Much of Apple's Top Product is US-Manufactured": <http://financesonline.com/how-iphone-is-made/>.

Buying for business use. In addition to purchasing items for resale or for transformation, a purchasing specialist is also likely to buy many goods and services for use by his/her own company. Purchasing specialists are often responsible for buying such items as equipment, equipment parts, tools, uniforms, furniture, supplies, and repair and maintenance services. Industrial buyers, in fact, engage in buying for business use as well as buying for transformation. They are often responsible for purchasing sophisticated machinery and equipment for business use. While these goods and services won't be resold or changed into finished products, they are necessary items for business operations.



▲ *Purchasing specialists don't just buy things for resale or transformation. They also buy things for their own companies to use, such as equipment.*

A hospital is a business that purchases many goods and services for its own use rather than resale or transformation. A hospital's purchasing specialists buy X-ray machines, dialysis machines, surgical equipment, beds, wheelchairs, scrubs, and an endless array of other items for the hospital. Without the necessary equipment, furniture, medicine, and supplies, the hospital could not properly care for or treat its patients.

Purchasing's Ultimate Goal

The ultimate goal and purpose of purchasing is always to obtain the right goods and services from the right suppliers at the right price, in the proper quantity, at the necessary quality, and with acceptable payment and delivery terms. To reach this goal, purchasing specialists must strive to do the following:

- Prevent interruptions in the production or provision of the finished good or service
- Purchase in amounts that make sense economically
- Seek out the best value
- Develop positive relationships with suppliers
- Buy from suppliers who are dependable and treat clients right
- Locate back-up sources of goods and services
- Reduce wasted time, money, and supplies
- Look for ways to enhance profitability and productivity



▲ *A hospital buys equipment, furniture, medicine, and supplies for its own use. Without these things, it wouldn't be able to take care of its patients.*

The Importance of Purchasing

Purchasing, both as a business function and as a business department, is essential to business success. Without effective purchasing policies and purchasing personnel, a company would not have the money, goods, or services necessary to survive.

As a business function. The purchasing function plays a vital role in business for a couple of reasons. One is that purchasing has the potential to generate further profit for a company. If a business spends the bulk of its money on materials and supplies, then finding a way to lower purchasing costs could save the company a lot of money. For example, when a housecleaning business locates a less expensive source of vacuums and cleaning products, then that business can save money on supplies. In addition, if much of a finished product's cost is materials cost, then lowering the cost of those materials could increase the profit margin for that product. Let's go back to the iPhone example we discussed earlier. If Apple is able to buy iPhone components for less, it can increase the profit margin.



- ▲ How do you think a business can increase its profit margin? One way is by lowering purchasing costs. If Apple buys iPhone components for less, the company can increase its profit margins.

The purchasing function is also important because virtually all businesses rely on some supplies, materials, equipment, or services in order to satisfy their customers. If a purchasing specialist doesn't do her/his job correctly and get the items or services that the business needs, then the business cannot produce its finished good or service. And if a company cannot produce its finished good or service, then it may lose money and possibly even go out of business—all because the purchasing specialist didn't do her/his job properly!

As a business department. Purchasing as a department also plays an important role in business. Purchasing specialists are involved in strategic planning in a number of ways. The purchasing department develops partnerships and alliances with suppliers, watches for business threats and opportunities, makes long-term purchasing plans, and looks for ways to improve processes. All are methods to plan, improve, and grow the business.

THE GRAY ZONE

Ashleigh is the purchasing specialist for a large downtown medical practice. The doctors in the practice recently acquired some office space north of town to turn into a branch office. Ashleigh is now responsible for equipping the new office space with furniture, equipment, and supplies. One of the costlier items that she needs to purchase is a photocopy machine.

According to the practice's purchasing policies, Ashleigh should conduct competitive bidding for the copier. Ashleigh doesn't really want to do that, though. She'd rather purchase the copier from a friend who works for an office supply company. This friend has promised her a great deal on the copier. Ashleigh would save herself time, trouble, and money if she purchased from her friend, and her friend would earn a hefty commission for the sale. What should Ashleigh do? Bend the rules and buy from her friend, or go through with the competitive bidding process? Why?

In addition, members of the purchasing department participate in new product development. They provide input on the best materials to use in new products, suggest alternative materials, and help make final material decisions based on the cost, quality, and availability. If research and development were to create a new product without getting input from the purchasing department, the new product might consist of materials that are overly expensive or hard to find. Such a product might cause the business to lose money instead of earning it. Once again, purchasing specialists play a major role in increasing profits for their businesses!

Summary

In business, purchasing involves buying goods and services for a business. Purchasing specialists may buy items for resale, for transformation, or for business use. Regardless of purchasing type, the ultimate goal of purchasing is to buy the right items in the right quantities at the right price from the right supplier with the right payment and delivery terms. Purchasing is important because it generates further profit and contributes to strategic planning and new product development.



1. What is purchasing?
2. Explain the three types of purchasing.
3. What is the ultimate goal of purchasing?
4. Explain two reasons why purchasing is important in business.



The Purchasing Process

Regardless of the type of purchasing, purchasing specialists implement a fairly standard purchasing process. This process consists of identifying needs, selecting suppliers, placing orders, and evaluating supplier performance.

Identifying needs. The first thing that a purchasing specialist is likely to do is identify the business's needs. In other words, what goods or services does the company need? To develop specifications or requirements for the goods or services to be purchased, a purchasing specialist might ask:

- What does the business need?
- How much of that item does the business need?
- What quality of that item does the business need?
- When is that item needed?
- What is the limit to what can be spent on this order?

Purchasing specialists don't always go through this lengthy purchasing process. Sometimes, a purchasing specialist places blanket purchase orders for fairly inexpensive goods or services that the business uses on a regular basis. Once the purchasing specialist has located a trustworthy, reliable supplier that can be used on a long-term basis, the purchasing specialist places a large order with the supplier to be delivered over six months to a year's time. Placing a blanket purchase order saves the purchasing specialist time, effort, and possibly money.

Read more about the uses and benefits of blanket purchase orders in "What is a Blanket Purchase Order?" by Heather Eastridge: http://www.ehow.com/facts_5158253_blanket-purchase-order.html.

After asking and answering such questions, a purchasing specialist may have to make another decision—a **make-or-buy decision**. Essentially, the purchasing specialist may need to decide whether the company can make needed parts or should buy them from a supplier. To make such a decision, the purchasing specialist should consider his/her company's production capabilities and the costs of making the needed parts. If the business is capable of making the needed parts and the cost would be low, then the company is likely to make the part versus buying it. On the other hand, if the company can't make the part or the cost of making it would be high, then the purchasing specialist is likely to buy it from a supplier.

Selecting suppliers. After identifying the business's needs and deciding to buy the needed good or service, the purchasing specialist normally starts the search for suppliers. S/He might search for suppliers on the Internet, in trade publications, through advertisements, in catalogs, from salespeople, or at trade shows. Once the purchasing specialist has located a handful of suppliers who offer the needed product, s/he usually starts the competitive bidding process. This requires a purchasing specialist to send out a request for bids to several prospective suppliers. The purchasing specialist provides specific information about the goods and services that the company needs and asks for a price quote from the suppliers. The potential suppliers then bid, either verbally or in writing, for the account. At that point, the purchasing specialist reviews the bids, or proposed prices, and chooses the best one.



▲ *A purchasing specialist can find suppliers in many places, including at trade shows.*

But what does choosing “the best one” mean? Does it mean the cheapest supplier or the supplier offering the best value? When it comes to selecting the “best” supplier, purchasing specialists follow purchasing policies that vary from business to business. At some companies, the purchasing specialist is required to always choose the lowest bidder. At other businesses, however, buyers are permitted to select the bidder offering the best overall terms, including quality and quantity, even if that supplier’s price isn’t the lowest.

In addition to or instead of competitive bidding, purchasing specialists often conduct negotiations with suppliers. During negotiations with a supplier, the two companies discuss many details of the purchase, including the price, quantity, quality, and delivery and payment terms. Talking things out prior to the purchase allows both the purchasing specialist and the supplier to discuss potential issues and ways to resolve them, thereby reducing later problems.

The purchasing specialist may also review the potential supplier’s credentials prior to placing an order. S/He might speak to the supplier’s references, visit the supplier’s plant, or even test the supplier’s product to ensure that the buyer is making the right choice.



▲ *Purchasing specialists often conduct negotiations with suppliers. Talking things out can reduce later problems.*



Once the purchasing specialist concludes that s/he has selected the right supplier for the job, s/he develops a purchase agreement or contract with the supplier. This document usually contains:

- The good or service to be purchased
- The quantity to be purchased
- The price
- Terms of delivery
- Payment information
- Warranty and guarantee information
- Other details as needed

Placing the order. After searching for and selecting a supplier, the purchasing specialist may place an order with the supplier. To indicate that the company is ready to make a purchase, the purchasing specialist sends a purchase order to the supplier. The purchase order, which may be the same as the purchase contract, restates the terms of the purchase.



- ▲ *When a company is ready to make a purchase, the purchasing specialist sends a purchase order to the supplier.*

Evaluating supplier performance. The last step in the purchasing process is typically evaluating supplier performance. After the purchased goods or services have been delivered, a purchasing specialist is often responsible for reviewing the order and determining if the supplier followed through on its promises. The purchasing specialist checks to see if the supplier sent the right items, in the right quantity and quality. S/He might also determine if the items were delivered at the right time and in the proper manner. Finally, the purchasing specialist normally reviews the invoice to see if the supplier charged the agreed upon price. Evaluating the supplier's performance allows the purchasing specialist to determine whether s/he should use the supplier again in the future and if there need to be any changes next time.

Check out the video "Purchasing Managers" from Jobs Made Real to learn more about what it's like to work in purchasing: <http://www.jobsmadereal.com/jobs/purchasing-managers.html?video=UyJ6RNh2xj0>.

Summary


Most purchasing specialists conduct a standard purchasing process to buy goods and services for their businesses. This process typically consists of identifying company needs, searching for and selecting suppliers, placing orders, and evaluating supplier performance.

Evaluation

- ☒ **Outstanding**
- ☐ **Very Good**
- ☐ **Satisfactory**
- ☐ **Marginal**
- ☐ **Unsatisfactory**

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- ▲ *How can purchasing specialists determine whether they should use their suppliers again? They must evaluate supplier performance.*



Chad Baker/Photodisc/Thinkstock Hemera/Thinkstock

TOTAL RECALL

1. What is a make-or-buy decision?
2. Describe the competitive bidding process.
3. What information does a purchase contract normally contain?
4. What are two questions that a purchasing specialist should ask when evaluating supplier performance?

Make It Pay!

Think about your school's athletic department. What goods and services does the athletic department purchase? Who purchases these goods and services for the department? What are some ways that this purchasing specialist could save money for the athletic department? What would happen if this person did not do her/his job as purchasing specialist properly?

