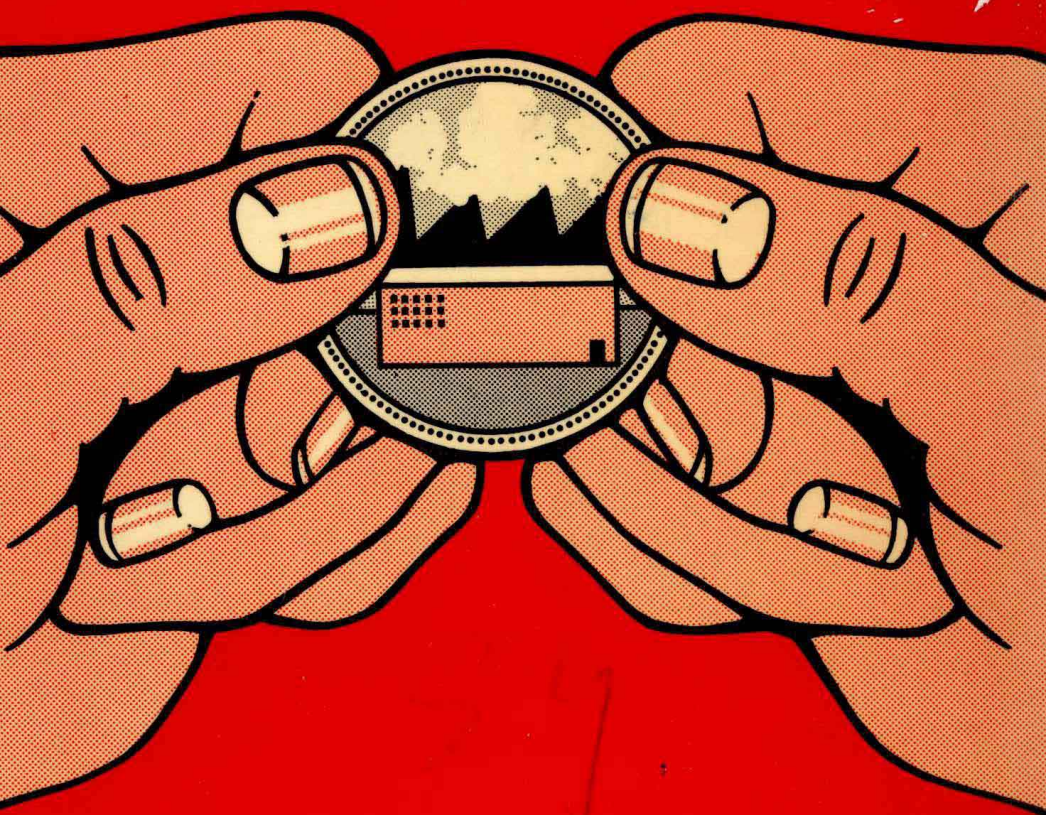


PURCHASING AND SUPPLY MANAGEMENT

FOURTH EDITION



P.J.H. BAILY

Purchasing and Supply Management

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Purchasing and Supply Management

Preface

The adoption by the Institute of Purchasing and Supply of a considerably revised education scheme made it necessary to revise this book if it was to continue to be useful to the Institute's students. Part One now corresponds to the *Introduction to Purchasing and Supply* subject, and Parts Two and Three to subjects at Final level — it is hoped that the book will also be useful to those studying purchasing and related subjects for BEC and CNAA awards.

The text has been extensively revised and brought up to date. A new feature is the inclusion of a large number of questions for review. Some new case-studies are also included.

Apart from the people and organizations to whom I owe thanks for quotations acknowledged in the text, I would particularly like to thank Dr. David Farmer for support, David Jessop who helped with the revision of two chapters, and Jill Baily, as before, for organizing the manuscript and my life while writing it.

P.J.H. Baily
Cardiff, February 1978.

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PART ONE:

Fundamentals of Purchasing and supply

Scope and objectives

Organizational purchasing is the process by which organizations define their needs for goods and services, identify and compare the suppliers and supplies available to them, negotiate with sources of supply or in some other way arrive at agreed terms of trading, make contracts and place orders, and finally receive the goods and services and pay for them.

Typically this process is complex. It can involve a number of people at various levels in the hierarchy and in several functional departments. It can be a lengthy process: major 'one-off' decisions may take years to finalize. Even routine repeat orders which are placed immediately may be placed in accordance with policy decisions reached after much consultation and experiment.

The purchase decision process is made more complex by its detailed involvement with several other decision and control processes within the organization. These may include, for instance:

- (1) in manufacturing organizations, and in some retail chains, the designing and specifying of products
- (2) in distributive organizations, the merchandising decisions: what goods will be carried and sold
- (3) the physical supply cycle which the actual goods pass through as they are despatched by the supplier, transported, received, stored, and issued or sold
- (4) the administrative cycle of requesting, ordering, progressing, receiving, paying for and accounting for goods
- (5) the stock control policies and procedures which determine, control and replenish the range of items stocked
- (6) in manufacturing, the production planning and control function

which determines and controls the quantities of parts and material required to meet production commitments

(7) the quality control policies and procedures which set standards, assess the capability of suppliers to meet standards, and control the quality of goods and materials

(8) the finance function as regards terms of credit, capital expenditure, budgets, stockholdings, and the payment of bills.

Occupational specialization in purchasing is sometimes described as a recent development. It is true that the overwhelming domination of the advanced economies by large organizations is a recent development. Large organizations operate by dividing their work forces into small working groups. These small working groups in turn are grouped into larger departments, and very often the departmentalization is along functional lines. Consequently, large organizations usually have one or more departments specializing in purchasing and possibly other supply activities. So in a sense the increase in the number of purchasing (and other supply) departments results from the increasing part which large organizations play in advanced economies.

A glance backwards

But long before the large organization appeared on the scene with its purchase department, people were buying — i.e. acquiring goods and services in return for a price — on behalf of organizations as well as on their own private account. Like selling — the disposal of goods in return for a price — buying for organizations dates back beyond the invention of written records. It is likely that human communities have always bought and sold to some extent, and have been enriched both culturally and materially by these transactions.

Did trade occur between primeval tribes in the long ages before history began? Archaeological evidence shows that it did; for instance, the distinctive products of a flint axe factory in the English Lakes at Langdale have been found hundreds of miles away in South Wales. The details remain for ever obscure: did Langdale have travelling salesmen in those distant days? Or did South Wales send out tribal buyers to search the land for better buys in stone age weaponry? We do not know. But it is known that among the earliest things to be written down were stock records and accounts of commercial transactions. At a time when literature and history were still recited from memory, the pioneer developments in written record, whether incised on baked clay in cuneiform or carved or painted in pictographs, dealt with purchase, stocks and sales.

Books were invented, and at first they dealt with higher matters than trade. Yet in the Bible itself, the oldest book in mass circulation, we read: 'It is naught, it is naught, saith the buyer; but when he is gone his way then he rejoiceth' (Proverbs 20.14). In Chaucer's *Canterbury Tales*, the oldest

work in the canon of English literature, several of the horseback pilgrims are described as 'purchasours' or (French having been the language of the ruling classes until recently) 'achatours'. No salesmen made the pilgrimage.

Many of Chaucer's pilgrims have occupational titles which with the passage of time have come to sound more like surnames; there was a 'manciple', for instance, described as an expert catering buyer. There was a 'reeve' who could 'better than his lord purchase', and no auditor could catch him out. The merchant was stately in his bargaining, and as for the sergeant of law,

So great a purchasour was nowhere none ...
Nowhere so busy a man as he there was,
And yet he seemed busier than he was.

There are buyers today who have never made a pilgrimage and do not know a reeve from a manciple of whom the same could be said.

Coming closer to our own time, during the nineteenth and early twentieth centuries many leading businessmen adopted an entrepreneurial approach to purchasing which made a major contribution to the success of their organizations, as has been discussed elsewhere[1].

Organizational buying today

The present-day organizations which are the subject of this book are engaged in manufacturing goods, providing services or distributing goods to consumers and users. Buying for such organizations has indeed something in common with the sort of buying which all of us do when we make purchases for our personal needs or those of our families, but it is also in a number of ways different, and it should not be assumed that experience in the one provides expertise in the other.

The scope and objectives of the purchasing function and its importance in the achievement of organizational objectives varies from one organization to another. In this chapter we consider next the differences and similarities between purchasing and supply in three major sectors of the economy: the distributive trade, the public sector, and manufacturing industry. These terms are all used in a broad sense; manufacturing industry for this purpose comprises all those organizations, public or private, large or small, which make or process goods or materials for sale; the public sector comprises central and local government and certain other public services; and the distributive trade or industry comprises all those organizations which buy and stock goods for resale, whether wholesale or retail, without alteration.

Distribution

The distributive industries, rather than mining, manufacturing or farming goods, arrange for them to be available where and when they are wanted. In the UK, described by a well-known Frenchman as a nation of shopkeepers, a hundred thousand school leavers a year join the distribution industry. It is not only a large, but also a diverse industry, and was not indeed regarded as a single industry until blessed with the services of the Distributive Industries Training Board (DITB).

It includes wholesalers and specialist agents selling to farms and factories and to other distributors such as retailers. But by far the largest part of the distribution industry is the retail trade, which handles the bulk of the distribution of goods from farm or factory to eventual consumer.

The organization of the retail trade alters continually as consumer needs change and the constraints imposed by law, society and the economy alter. Mail order, credit trade, co-ops, supermarkets and hypermarkets have appeared and flourished as needs and opportunities were perceived. Three typical forms of retailer are:

(1) independents: traditional owner-managed establishments, which have existed since civilization began and can be found everywhere in the free world: corner shops, husband-and-wife businesses, etc.

(2) department stores: merchandise is split into several groups each of which is bought and sold by a separate department.

(3) chain stores: a number of stores sell the same lines of merchandise which is bought centrally. The goods can be all in one product group such as shoes or food; alternatively they can be a variety of descriptions as with Woolworths.

Buying is a vital function in all distributive organizations, since the whole business of the retailer is to buy goods, hold stock, and sell goods. 'Whether the firm is large or small, wholesale or retail, if it doesn't buy what it sells, or doesn't sell what it buys, it is heading for trouble', points out the DITB booklet *Training to Buy*. 'Two major ways of losing profit are to have unsold goods gathering dust on the shelves and to have unsatisfied customer demand.'

Buying decisions are normally taken by the managing proprietors in the small independent businesses which make up the great majority of establishments. Most of the people who work in distribution, however, are employed by the 1600 firms with over a hundred employees. Buying decisions in these larger firms are usually taken by specialists.

In department stores, traditionally each department is managed by a buyer whose responsibilities include sales and staff supervision as well as buying. This total departmental responsibility is said to motivate the buyer to perform well as making for high job satisfaction.

In chain stores, buying is usually centralized. This central buying is the principal economy of scale available to the distributor and has been one of

the main reasons for the growth of the great chains during the middle part of the century. The physical supply arrangements may be either direct from suppliers to branches, or from suppliers to one or more central warehouses and from there to branches.

When a multiple operates retail outlets which differ in character, as well as in size or location, stores managers may be given some discretion in the selection and pricing of merchandise even though central buying is the normal policy. (This approach is adopted in the UK at present by John Lewis and House of Fraser. It is of interest also that Harrods and Carrefour, the old and the new as it were, both give full purchasing responsibility to the department head or buyer despite the trend towards central buying.)

Inevitably this growth in central buying has led to a diminution in the role of the wholesaler. Retailers obtained most of their merchandise from wholesalers in the early part of the century. Wholesalers 'broke bulk', i.e. bought large lots from manufacturers and supplied small lots to retailers, often on credit. Although major retail chains now deal direct with manufacturers, some wholesalers still do well as special middlemen for the smaller retail outlet, with developments such as cash-and-carry warehouses and voluntary buying chains. Industrial distributors, who supply goods and other services on a wholesale basis to manufacturers and public sector organizations, have also played an increasing part in the UK and the USA in recent years.

There are obvious differences between the work of the retail buyer and that of the industrial or public sector buyer, but also (as considered later in chapter 16) there is much common ground. Industry and the public sector have taken a particular interest in the purchasing policies and procedures of one very successful retail chain, Marks & Spencer Ltd, which pioneered a new approach to supplier relationships.

The company's annual reports usually refer to supplier relationships in glowing terms. In 1972 for instance the chairman said:

The unique relationship we enjoy with our manufacturers has been built up over many years of joint effort to extend and improve the range of St. Michael merchandise. Our partnership is based on commercial and technical collaboration between independent companies with a common interest and approach to production, management and human relations. We are working together on a range of problems from technology, engineering and administration to staff management and welfare. We have noted with pleasure their parallel growth to ours and appreciate that they have increased their productive capacity to be able to meet the growing demands of our public.

Goods are made to detailed specifications by carefully selected suppliers. Production and quality control advisory services are offered by Marks and Spencer to guide and assist suppliers in complying with exacting standards.

In the words of the firm's official history[2], 'through its technical services and its merchandising departments Marks & Spencer undertook to ensure that at every stage of production back to the primary producer of the raw fibre the needs of the consumer were represented, and at each stage of production its specialists and technologists collaborated with the firm responsible'.

These specialists and technologists were not 'backroom boys who operated in mysterious isolation. They were fully integrated into the commercial organization of the business, so that they were active and indispensable members of its buying department'.

The public sector

The term 'public sector' denotes a collection of services which come more or less directly under government control. It is generally considered to include:

- (1) central government itself, with its many departments and agencies
- (2) certain other services provided nationally, such as in the UK, the Health Service or in the USA, NASA
- (3) for some purposes, the nationalized industries
- (4) local authorities.

Central government

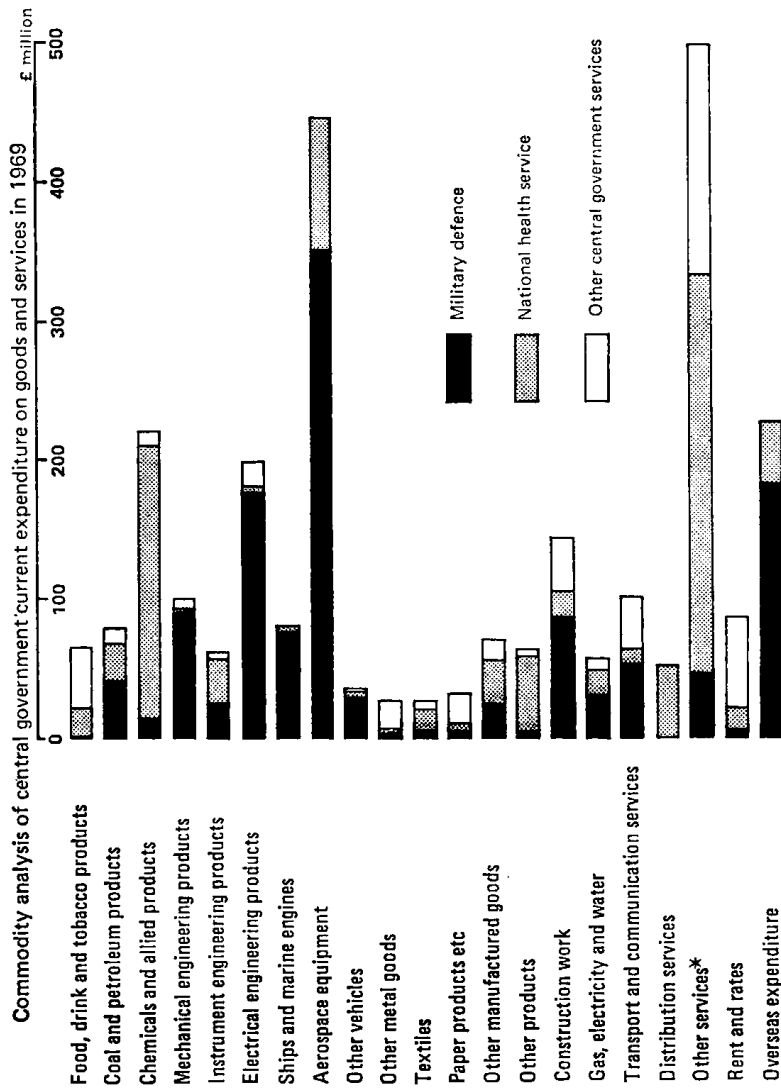
The increasing scale of government activities and interventions place government procurement agencies high among the big spenders of the world. Probably the largest single purchaser of goods and services in existence is the United States federal government, if indeed when so many departments and individuals are involved it is meaningful to speak of a single purchaser.

The United Kingdom government buys about 10% of the entire output of UK manufacturing industry. The range of purchases is immense, from such things as paint and cleaning materials which are in common supply, to complex weapon systems, and is shown in Figure 1.1. Certain industries, such as aerospace and computers, are heavily dependent on public sector patronage, both in the UK and in the USA. Complex issues of power and control and the relationship between the public and private sectors are raised by some of these transactions.

The main aim in government buying has been defined as 'to obtain what is needed at the right time and in such a way as to ensure the best value for money spent' (White Paper on Public Purchasing, 1967, Cmnd 3291). This is almost a textbook definition of the main declared aim of most organizational buying, yet between the normal practice in industry and the normal practice in government buying, considerable procedural differences have developed.

The basic reason for these procedural differences is the need for public

WHAT THE GOVERNMENT BUYS



*Includes insurance, banking, finance, business services, professional and scientific services and miscellaneous services

Figure 1.1 What the UK government buys. Breakdown of British government expenditure in 1969: from the Treasury 'Economic Progress Report' for November 1971.

accountability in the expenditure of public money. Government buying, it is thought, should be organized and executed in such a way that it not only is, but can be seen and shown to be, honest, fair and impartial. This laudable objective has led to procedures which provide enough recorded data to construct and support an answer to any public criticism, including questions in Parliament, and to satisfy the external auditor. (When Chaucer praised the purchasing ability of his sergeant of law because 'there was none auditor could on him win', he was no doubt drawing on his own experience as a government employee.) Since job security is a high priority for the public sector employee, and since his normal payment system provides little scope for rewarding unusual successes but plenty of scope for penalizing failures, there has also been a tendency for all purchasing decisions to be taken by committees so that no individual could be held accountable for success or failure.

Attempts are being made to change this, and the organization and methods used for government buying are under constant review. Most of the many Civil Service buying units already have extensive buying responsibilities. The Procurement Executive, for instance, handles all the requirements of the armed forces. The Stationery Office buys paper and supplies printed documents. The Property Services Agency provides accommodation and equipment for all government departments. There is much scope for standardization in such items as office furniture, carpets and cleaning materials which are in common use, and bulk purchasing of standardized requirements can bring substantial savings; but there are limits to what can be achieved. There is the need to stimulate innovation by suppliers and to keep competition alive; the capacity of firms is also in some cases a limitation. Large-scale central contracting has been shown to be economical in some cases, but in other cases local contracts with short local deliveries have been equally economical and have generally provided a good service. It is advisable to avoid doctrinaire positions in matters of this kind and to look at the facts which apply in particular cases at particular times.

Other public services

The public sector also includes other public services provided nationally. In the UK this includes the Health Service, comprising hospitals and other health care institutions located all over the country, whose combined purchasing power would be equivalent to a major industry. It is a major, and in some cases a monopoly customer for the pharmaceutical and related manufacturing industries.

The nationalized industries

The nationalized industries are a diverse collection, constantly being added to. Some are entire productive industries such as coal mining and steel making, formerly comprising many private organizations which have been taken over by Act of Parliament and converted into state monopolies.

Some are parastatal organizations which have never existed except as public property, such as the British Broadcasting Corporation. Some are major concerns which were taken over to avoid bankruptcy and maintain employment. The Post Office was for 300 years a government department or Crown Office until it was converted into a public corporation on the nationalized industry model.

The nationalized industries are part of the public sector firstly because they are public property; and secondly because, as a result of this, a high standard of propriety is required in the allocation of contracts. Public accountability is a proper accompaniment of the expenditure of public funds, and although it is not interpreted in quite the same way for nationalized industries as it is for government departments, nevertheless the several investigations which have been made into, for instance, the Purchasing and Stores operations of the National Coal Board, were probably more severe and detailed and conducted more in the spotlight of public scrutiny than would have been the case if the Board had not been heavily subsidised by the taxpayer.

Thirdly, nationalized industries belong with the public sector because the government, through the appropriate minister, retains powers of last resort, such as to appoint and discharge the chief executive, and to approve or reject major capital expenditure proposals. The minister may also have or seek to exercise ill-defined powers to influence policies and decisions in the industry in accordance with the wishes of the government of the day. Purchasing policies at the highest levels have been affected, in the UK, by government pressure to buy British computers or British aircraft; and in the USA by similar pressures to buy American computers or American aircraft. Many governments — Arab, American, British, African — also try to use international trade as a lever or instrument in furthering their diplomatic policies. Firms are urged or compelled not to deal with countries which are out of favour with the government, and ministers tend to lean most heavily on the nationalized industries.

But at the operational level there is often little difference between industrial purchasing in a nationalized industry and industrial purchasing in one which is not nationalized. There is free interchange of purchasing staff. Policies, practices and career prospects in nationalized industries such as the British Gas Corporation seem to resemble those in comparable private sector organizations such as Unilever, Shell or ICI more than those in government departments.

Local authorities

Until the mid-seventies the number of local authorities existing in the UK was large — about 1800 — and although their total expenditure was sizeable (£6827m, equivalent to about 15% of the gross national product in 1970), many of them were small organizations and most had no arrangements for central purchasing.