

Chapter 9

Procurement and Purchase Management

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Introduction

Management is much concerned about the means and method by which materials are bought into the organization for internal operations. In fact, a careful and detailed budgetary provisions have to be made, considered and analyzed before approval, when it comes to purchasing decisions. This is because of the attention given to the kind of material to be purchased and way at which materials are valued in the organization. Hence, purchasing is the first phase of Materials Management, and the most important function of material management. A significant or a large sum of a firm's finance (money) outflow is used or blocked in materials acquisition. If the size or volume of the materials that is needed in the firm are large and it requires a continuous (repetitive) for production activities, then a separate purchase department would be established to handle such volume of activities. The function of purchasing department is closely connected with production and marketing functions, the efficiency of these production and marketing departments depends upon the efficiency of purchase department. It ensures that right type and quality materials are available in right quantity and at right time.

Purchasing activity has been greatly influenced by the level of globalization, standardization and competition in our contemporary market. This is because, both industrial and commercial good or services are consumed across national and international boundaries, making purchasing or procurement an international activity. This could further be illustrated using our country Nigerian as a case. Most of our industrial, commercial and consumption goods and services are largely procured from other countries.

Definition of Purchasing

In it's simplest meaning, purchasing is also known as procurement, and both terms will be used interchangeably in this section. It is the act of requesting and paying for a product or goods by an individual or a company from the seller (individual, producer, and supplier) that will be used for production or consumption. It requires a careful and detailed planning process, in accordance with budgeting line or provisions.

Thus, purchasing is an operation of market exploration to procure goods and services of desired quality, quantity at lowest price and at the desired time. Supplier who can provide standard items at the competitive price are selected. Hence, product, goods or services to be purchased are known, itemized with it's associated cost, and budgeted for.

Purchasing means procurement of goods and services from some external agencies. The aim of purchase department is to arrange the supply of materials, spare parts and services or semi-finished goods, required by the organization to produce the desired product, from some agency or source outside the organization. The purchased items should be of specified quality in desired quantity available at the prescribed time at a competitive price.

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Purchasing is the procuring of materials, supplies, machines, tools and services required for equipment, maintenance, and operation of a manufacturing plant. The procurement and purchase of the proper materials, machinery, equipment and supplies for stores used in the manufacture of a product adopted to marketing in the proper quality and quantity at the proper time and at the lowest price, consistent with quality desired are purchasing activity. Thus, purchasing is an operation of market exploration to procure goods and services of desired quality, quantity at lowest price and at the desired time. Supplier who can provide standard items at the competitive price are selected. Purchasing activity in a firm has now become a specialized function with it's designated unit known as Procurement. It was experienced that by giving the purchase responsibility to a specialist, the firm can obtain greater economies in purchasing. Moreover purchasing involves more than 50% of capital expenditure budgeted by the firm.

Purchasing is a managerial activity that goes beyond the simple act of buying. It includes research and development for the proper selection of materials and sources, follow-up to ensure timely delivery; inspection to ensure both quantity and quality; to control traffic, receiving, storekeeping and accounting operations related to purchases." The modern thinking is that Purchasing is a strategic managerial function and any negligence will ultimately result into decrease in profits.

Purchasing Planning

This is the process of identifying the needed materials that would be required or needed for procurement from vendors, suppliers, and subcontractors outside the operating or performing organization, and should be accomplished during or within a scope of definition effort. It involves the consideration of whether to procure, how to procure, what to procure, how much to procure, and when to procure. It is important to note that in procurement planning, there are different solicitations and contract to be considered or entered with the vendor, suppliers or subcontractor. In procurement planning, the following details are important:

1. **Scope Statement:** this provides important information about the level work or operation to needed to be carried out, and the strategies that must be considered during procurement planning.
2. **Materials Description:** this provides important information about any technical issues or concern that would need to be considered during procurement planning. In most cases, material description are usually broad, because it describes the ultimate end materials need for organization's operation.
3. **Procurement Resources:** This is very critical, because it requires expertise skill, and knowledgeable personnel in procurement matters. If the organization do not have the required competence (department of team) to provide the knowledge, then it's important for management to outsource that would provide support for procurement activities.
4. **Market Conditions:** the procurement planning process must consider what materials, products, and services that are available in the market place, with indicators as; from whom, under what terms and conditions
5. **Other Planning Details:** this would require the procurement team or management to take a critical look at previous planning contracts or documents that may be of guide during procurement planning. Details that should be considered are preliminary cost of material and schedule estimates, quality management plans, cash outflow projections, work breakdown structure, identified risks, and planned staffing system (when the operation required needs supportive staff)
6. **Constrains:** These are factors that inhibits management or procurement options, such as capital (liquid)
7. **Assumptions:** These are factors that, for planning purposes will be considered to be true, real or certain.

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Techniques for Purchasing Planning

1. Make-or-Buy Analysis

This is a major or general management technique and a part of the initial operation scope definition process that can be used in determining whether a particular material or product can be produced at a cost effective rate by the organization. In determining this, analysis such as both indirect as well as direct costs are evaluated. This analysis must also reflect the perspective of the organization as well as the immediate need of the work or operations to be performed. For example, purchasing a capital item such as power generating plant to a 3 KVA generator, rather than renting, hiring may or may not be cost effective.

2. Expert Judgment

Expert technical judgment would provide the needed information to be used. Such knowledge can be sourced from the procurement department or externally, such as consultant, industrial groups.

3. Contract Type Selection

There are different types of contracts that are more or less appropriate for different types of procurement. These contracts are broadly classified into three categories:

- a. **Fixed Price or Lump Sum Contract:** This is a type of contract that involves a fixed total price for a particular material or product to be procured. But in a situation where the material is not well defined, both the buyer and the seller are at risk. The buyer may stand not receive his desired material and the required quality and quantity, or the seller may need to incur additional cost to provide it. Also, in such cases of fixed price contract, provisions as to incentives for meeting or exceeding specifications is required.
- b. **Cost Reimbursement Contract:** This type of contract would require payment and repayment clause to the seller for the actual cost (direct) of the materials and his required profit and other sundry expenses (Indirect) for the service rendered, which is usually a percent of direct cost. Cost reimbursable contract also includes incentives for meeting or exceeding requirements.
- c. **Time and Material (TAM) Contract:** This contract is a hybrid of contractual arrangement between fixed price and cost reimbursable contract. TAM contract is a resemblance of cost reimbursement because of its open ended nature, in the sense that, the full value of agreement is not defined or specified at the time the contract was awarded. Also, it has the nature of fixed price contract, in the sense that, unit price of materials supplied are predetermined and agreed upon by both the buyer and the seller.

Importance of Purchasing

1. Purchasing function provides materials to the factory without which wheels of machines cannot move.
2. A one percent saving in materials cost is equivalent to a 10 percent increase in turnover. Efficient buying can achieve this.
3. Purchasing manager is the custodian of his firm's purse as he spends more than 50 per cent of his company's earnings on purchases.
4. Increasing proportion of one's requirements are now bought instead of being made as was the practice in the earlier days. Buying, therefore, assumes significance.
5. Purchasing can contribute to import substitution and save foreign exchange.
6. Purchasing is the main factor in timely execution of industrial projects.
7. Materials management organizations that exist now have evolved out of purchasing departments.
8. Other factors such as:
 - (i) Post-war shortages,
 - (ii) Cyclical swings of surpluses and shortages and the fast rising materials costs,
 - (iii) Heavy competition, and
 - (iv) Growing worldwide markets have contributed to the importance of purchasing.

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Objectives of Purchasing

Objectives of procurement and purchasing is categorized into 2. However, this may not necessarily be the same for all organization, but depending on the scope of operation and materials requirement

1. General Objectives

The purchasing objective is sometimes understood as buying materials of the right quality, in the right quantity, at the right time, at the right price, and from the right source. This is a broad generalization, indicating the scope of purchasing function, which involves policy decisions and analysis of various alternative possibilities prior to their act of purchase.

2. Specific Objectives

1. To pay reasonably low prices for the best values obtainable, negotiating and executing all company commitments.
2. To keep inventories as low as is consistent with maintaining production.
3. To develop satisfactory sources of supply and maintain good relations with them.
4. To secure good vendor performance including prompt deliveries and acceptable quality.
5. To locate new materials or products as required.
6. To develop good procedures, together with adequate controls and purchasing policy.
7. To implement such programs as value analysis, cost analysis, and make-or-buy to reduce cost of purchases.
8. To secure high caliber personnel and allow each to develop to his maximum ability.
9. To maintain as economical a department as is possible, commensurate with good performance.
10. To keep top management informed of material development which could affect company profit or performance.
11. To achieve a high degree of co-operation and co-ordination with other departments in the organization.

Types of Purchasing

1. Centralized
2. Decentralized

There are different form of purchasing that are executed in an organization, dependent on the nature of the organization's business activity and the materials to purchase. Purchasing program should be framed so that the requirements are procured as and when needed and at the reasonable price.

The term scientific purchasing is used in relation to the purchase of proper materials, machines, equipment and supplies or stores used in the manufacturing of a product, adopted to marketing the proper quantity and quality at the proper time, and at the lowest price consistent with the quality desired. In order not to lose focus as it concerns the size and requirements of the organization, purchasing is either centralized or decentralized.

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Centralized Purchasing

When all types of purchasing are performed at one level, it is known as centralized purchasing. A separate department, known as purchase department, is set up for this purpose. All departments send their purchase requirements to purchase department and it arranges procurement of various goods needed.

Centralized purchasing form is used when:

1. The organization is using few materials whose quality and availability are vital to the success of the organization
2. Purchasing small items of fairly high value such as tool bits, grinding wheels, and dial gauges, etc., as well as those for which bigger quantity discounts can be obtained.

Advantages of Centralized Purchasing:

- (i) it makes for more efficient ordering of materials
- (ii) it forms a basis to gain bargaining advantage
- (iii) it eliminates duplication of efforts
- (iv) it helps in procuring uniform and consistent materials
- (v) it simplifies or makes purchasing procedure easy
- (vi) it simplifies and makes the payment of invoices much clearer
- (vii) it gives provision and permits a degree of specialization among buyers.

Disadvantages of Centralized Purchasing

1. Centralized purchasing is little slower and more cumbersome than decentralized purchasing.

Decentralized (Localized) Purchasing

This type of purchasing is suitable for organizations where there are more than one plant or the plants are situated at different places. Every department or plant as the case may be, is authorized to make its own purchases. A separate purchasing agent is appointed for every department or plant. To enforce general purchasing policies all the purchasing agents are put under the charge of general purchasing agent. He gets periodical reports from all purchasing agents. This helps in exercising control over materials. This system has some advantages as well as disadvantages.

Decentralized Purchasing form is used when:

1. Where different plants of a large organization require quite different types of materials.
2. Where branch plants require heavy and bulky items such as oil products, fuels, paints, etc.
3. Where purchases are to be made within the local community to promote better public relations.

Advantages of Decentralized Purchasing

1. Improved efficiency.
2. Faster procurement of materials.
3. Control over purchases is no longer remote.
4. Decentralized operations are more flexible.

Disadvantages of Decentralized Purchasing

1. Less quantity discounts.
2. Involves duplication of efforts.

Functions of Purchasing Department

- (i) Keep records-indicating possible materials and their substitutes.
- (ii) Maintain records of reliable sources of supply and prices of materials.
- (iii) Review material specifications with an idea of simplifying and standardizing them.

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- (iv) Making contacts with right sources of supply.
- (v) Procure and analyze quotations.
- (vi) Place and follow up purchase orders.
- (vii) Maintain records of all purchases.
- (viii) To make sure through inspection that right kind (i.e., quantity, quality, etc.) of material has been purchased.
- (ix) To act as liaison between the vendors and different departments of the concern such as production, quality control, finance, maintenance, etc.
- (x) To check if the material has been purchased at right time and at economical rates,
- (xi) To keep an uninterrupted supply of materials so that production continues with least capital tied in inventories.
- (xii) To prepare purchasing budget.
- (xiii) To prepare and update list of materials required by different departments of the organization within a specified span of time.
- (xiv) To handle subcontracts at the time of high business activity.
- (xv) To ensure that prompt payments are made to the vendors in the interest of good public relations.

Procurement and Purchase Organization

Procurement and Purchasing department is a staff function in the overall company structure. The internal organization of the purchasing department is on a line basis, with purchasing agent, director of purchases or purchasing manager being the in charge of purchase department. He is responsible for the overall efficient operation of the department. The purchasing manager is, however, assisted in purchasing by a number of assistants and a few clerical staff. The purchasing manager has the powers to execute purchasing contracts for the concern or the organization. He divides the duties among the assistants according to the nature of purchases to be made. For example, one assistant may purchase only electrical goods, another (major) raw material, third, plant equipment and so on. This functional division of efforts makes for increased specialization and gives a chance to the assistant to better feel and know the market, he is assigned.

The department have three main sections namely:

1. Purchasing: this section places orders with the vendors.
2. Purchase Service: this section follows the progress of the order at vendor's end, its shipment by the vendor and its final receipt in the company.
3. Records: this section maintains all records of quotations, costs, purchases, etc.

Organization and Project Procurement

It is the process of acquiring goods and services in order to attain production or project scope, from outside the performing organization. For the purpose of clear understanding, it is better to classify goods and services irrespective of its quantity as products. The processes of procurement interacts with each other. Each process may involve effort from one or more individual or groups of individual, based on the needs of the organization or project. Although, the processes are presented as separate elements with well-defined interfaces, but in real life they may overlap.

Buyer and Seller Relationship in Procurement Management

The buyer – seller relationship can exist at many stages of a project life, depending on the application area, the seller may be called a subcontractor, a vendor of a supplier. The seller will typically manage its work as a project, such as:

- a. The buyer becomes his customer and a key stakeholder to the seller
- b. The seller's project management team must be concerned with all the processes of production or project management, not just with those of his knowledge area.
- c. The terms and conditions of the contract becomes a key input to many of the seller's processes. The contract may actually contain the input such as major deliverables, key

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milestones, and cost objective; or it may limit the production or project team's options such as, buyer's approval of staffing decisions is often required on design projects.

Procurement Planning

This is the process of identifying which organizational need can best be met by procuring products or services outside the performing organization, and should be accomplished within the scope definition. It involves consideration of whether to procure, what to procure, how much to procure, and when to procure.

When production department receives product and services from outside the performing organization, which is as a result of the processes from solicitation planning through contract closeout is performed once for every product or services. The production or project management team may want to ask for support from experts in the relevant areas of contracting and procurement as needed, and involve them in the early stage as part of the production team. But when production does not receive products or services from outside, the process of solicitation planning to contract closeout would not be needed. However, procurement planning do consider the inclusion of potential sellers, most especially if the buyer would exercise some measure of influence or control over contracting decision.

It would be of need to discuss procurement planning processes in three different phases, which are inputs, techniques, and outputs.

Inputs

- a. **Scope statement** – this explains the relevant production limits. It provides important information about production needs and strategies that must be considered during procurement planning.
- b. **Product description** – this gives explanation to the items needed, and important information about any technical issues of concern that would be of use when carrying out procurement planning. Of good note, product description is usually broad, because it explains the ultimate end product of the production phase. A statement of work is a document that only describes part of the product that need to be procured. But if the performing organization decides to procure the whole product, then there would be no need to make distinction between product description and statement of work.
- c. **Procurement resources** – When an organization do not have a formal contracting agency, then the production or project team will be required to supply resources and skill in order to support production procurement activities.
- d. **Market Conditions** – During the procurement planning process, what product and services that are available in the market place need to be considered; the question to bear in mind is who have the product and under what condition and terms are required to enter into.
- e. **Other planning outputs** – this would consider the preliminary cost of products and services and the schedule estimates, quantity management plans, cash-flow forecast, work breakdown structure, identified risk, and planned staffing. This is outside the fact that every other planning outputs are readily put in place.
- f. **Constrains** – these are variables that hinders the buyer's choice; such as adequacy of finance.
- g. **Assumptions** – in carrying out procurement planning, assumptions are necessary because it helps to determine true position in the decision to make or take.

Techniques for Procurement Planning

- a. **Make or Buy Decision** – the overall management technique and the initial scope definition process can be used to determine whether a particular product or service can be produced at a cost effective rate by the performing organization. adequate evaluation about this would give rise to both form of cost such as direct and indirect. This decision must also recognize the views of the performing organization, as well as the immediate needs of the production

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team or project. Such example would be the need to hire and expertise skill or to develop, the option to buy official vehicles for the project team or the hire.

- b. **Expert judgment** - there is what is known as technical judgment that can only be proffered by a professional in the knowledgeable area of need, which can also be rendered by individual or group. However, there are other sources through which such skill can be made available if it is not from or within the units of the performing organization; such as consultants, professional or technical association, and industry groups.
- c. **Contract Type Selection** – in carrying out procurement activities, it is expected to have of determine different forms of contract. However, contracts generally falls into one form of the three general classifications:

Fixed price or lump sum contracts – this is of a situation where the product is well known and its total price is fixed. It is when the item is not known that the buyer and seller are both at risk. The risk in it is that, the buyer may receive fake or it may not be the exact product or desired item he want to buy; while on the other hand, the seller may need to incur more expenses just to make the product available for sale. In most cases, contracts that are of a fixed price do usually attracts incentives for meeting or exceeding selected project objectives, such as schedule targets.

Cost reimbursement contracts – this is another classification of contract which specify that the seller makes the item to be procure available to the buyer, while the buyer pay for both his expenses and profit. It also do attract incentive as in fixed and lump sum contracts. Thou, costs are usually in direct and indirect. A very brief explanation on this: direct costs are cost incurred that are of direct use to the project, such as payment of staff salary, while indirect costs are of overheads, on-going concern, etc., which are usually calculated as a percentage of direct cost.

Time and Material Contract (TM) – this is a contract that is usually known as hybrid because of its combination of fixed price and reimbursement contract. It is a type of contract that is open ended, in the sense that the full value of the arrangement are not usually defined at the time the contracted was entered into, but any of the two modes of payment can be adopted as agreed on by both parties.

Outputs from Procurement Planning

- a. **Procurement management plan** – since it is an output, it explains how unattained procurement processes should be managed, ranging from solicitation down to contract closeout. Some of the fundamental questions that need an answer are: what are the types of contract to be used? If independent estimates are needed as evaluation criteria, who will prepare them and when? When the performing organization do not have procurement unit, what decision should be taken by the project management team? When standard procurement document are need, where can it be sourced? How can different vendors be coordinated? How can procurement activity be executed without obstructing project schedule and performance reporting?
- b. **Statement of work (SOW)** – this document prescribes and describes the procurement products in detail in order to enable prospective sellers to determine if they would be capable of supplying them, based on the nature of the product, the need of the buyer, or the expected contract form. For some application area, say in government controlled area, SOW is reserved for procurement of products or services that are clearly specified. While statement of objectives (SOO) is a document that is used to procure product that are of a problem to solve.
This statement SOW has the capability to be refined and be redefined as the case may be. For instance, in a situation where can be lesser, or a different method that can be used to procure the product as suggested by the prospective seller. It is require that each product

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or item to be procured should have a separate SOW, and it is not wrong to have different product or service in a single SOW, all depends on what to be achieved. SOW need to be structured in clarity and simplicity, and its format is solely dependent on the organization and what to be procured.

Solicitation Planning

Solicitation is the obtaining or receiving of responses (bids and proposals) from prospective sellers on how materials or products can be supplied. Solicitation planning involves the preparation of document needed to support solicitation process.

Documents used for Solicitation

Standard Form: This is one of the most used technique in solicitation planning. It involves standard contracts, standard description of procurement items, or standardized version of all or part of needed bid documents. Organizations that are substantially involved in high volume of procurement are expected to have all their documents standardized.

Procurement documents are used to solicit proposal from prospective sellers. There are some basic terms used for procurement documentations, such as:

1. **Bids and Quotations** are generally used when the source selection decision will be based on price, such as buying commercial or standard items or materials
2. **Proposal** is used when other considerations such as technical skill or technical approach are required. Though both bid, quotation and proposal are often used interchangeably which is wrong in professional procurement standards. Proposal is suppliers prepared document that describe the supplier's ability and willingness to provide a requested product or service. This document is prepared in accordance with the requirements of the relevant procurement documents, which may be in combination with oral presentation.
3. **Others are:** Invitation for Bid (IFB), Request for proposal (RFP), Request for Quotation (RFQ), Invitation for Negotiation (IFN), Contractors Initial Response (CIR).

Procurement documents should be structured to facilitate accurate and complete responses from prospective sellers. They should always include the relevant Scope of Work (SOW), a description of the desired form the response, and any required contractual provisions (e.g., a copy of the model contract, nondisclosure provisions). But when government is contracting, some or all of the content and structure of procurement documents mat be defined by rules and regulations. Procurement documents are required to be rigorous enough to ensure consistent, comparable responses, but flexible enough to allow consideration of sellers suggestions for better ways to satisfy the requirements.

Evaluation Critical this is an analytical exercise that used to score and rate proposal. They may be objective or subjective, and the procurement management is by expectation to have the requisite experience and previous document with similar procurement details as a guide in his evaluation process. This evaluation process may be solely limited to price relation issues if the procurement materials is readily available from a number of acceptable sources, vendors, or suppliers. The purchase price of item to be procured includes both cost of item and ancillary and documented to support to support the assessment. Such assessment may range from:

Understanding of Need: this is a demonstration shown by the seller's proposal about the require material or item to be sold

- a. **Overall or Life-Cycle Cost:** this is the readiness of the selected seller to sell the material or item at a reduced total cost, including purchased cost and operating cost.
- b. **Technical Capability:** this is a determination of the sellers expected competence, to have the required technical skill and knowledge needed use or operation the item

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- c. Management Approach:** this consider some of the latent question about the seller, such as does the seller have or can he be reasonably expected to develop management processes and procedures to ensure a successful procurement
- d. Financial Capability:** the question in mind to be answered hinges on the finance. Does the seller have or can he reasonably be expected to obtain the necessary financial resources?

Qualified Suppliers list: As it is obtainable in most procurement departments, there is an already existing list of files that contains information on prospective vendors. The list contains the general information on relevant past experience of prospective suppliers. If such list are not readily available, then the procurement department will have to develop their own sources. Some of the major source for such general information about suppliers is the internet, library, directories, relevant local associations, trade catalogs, and similar sources. Detailed information on specific source may require more extensive effort, such as web site or contacts with previous customers. Usually, procurement document are sent out to prospective suppliers or vendors.

Methods for Attracting Solicitors

However, means for which an organization can use to attract or inform prospective solicitor (suppliers or vendors) absolutely rest on the organization. But the most notable methods are:

- a. Bidders Conference:** this is a very popular method that is easily adopted with a high level dignity to suppliers. This is a means of calling for a meeting with prospective suppliers prior to or before preparation of proposal. Bidders conference is used to ensure that prospective suppliers have a clear, common understanding of the procurement details, such as, technical and contract requirements, etc. During the conference, responses to questions may be incorporated into the procurement document as amendments, and all potential vendors must be on equal standing during conference proceedings. This method is also known as **contractors' conference, vendors' conference, and pre-bid conference.**
- b. Advertisement:** this is another source for which list of potential vendors can be enlarged through general publication and circulars, such as newspapers, and specialty publications such as, professional journals. Some government jurisdictions require public advertisement of certain types of procurement products; also in public advertisement of subcontracts on a government

Source Selection

Procurement is a big deal to the organization, and much attention and concern is placed on the type of supply the organization receives or get. Thus, source selection is a critical activity that involves the receipt of bids, tender or proposals and the application of the evaluation criteria to select suppliers. Many factors aside from cost or price may need to be analyzed in the source selection process. Details to analyze includes:

1. Price may be a primary consideration for an off-the shelf product, but the lower proposed price may not be the lowest cost if the supplier proves unable to deliver the product at due time.
2. Proposals are often separated into technical and price related segments, with each analyzed exclusively
3. Multiple source of selection may be necessary for essential items needed
4. Selecting a single source which will require signatory for standard contract
5. Rank order is required for all proposals with the aim to establish a negotiation process. When it is a major procurement item, this process may be repetitive in nature. Giving provision for a short list of qualified suppliers to selected based on a preliminary proposal, and then a more detailed analysis will be conducted based on a more detailed and comprehensive proposal

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Rules Guiding Source Selection

The rules are basically dependent on the organization and her past experiences in procurement activities. However, such may be of consideration:

- a. The proposal, which entailed how it is been structured and proposed in line with expected standard and description required
- b. Evaluation criteria which may include samples of the suppliers previously supplied item or service for the purpose of providing a way to analyze their competencies and capability on the required product. Which may include a review of the suppliers' history with the contracting organization.
- c. Organizational policies which stipulates formal guides lines for evaluating and analyzing proposals

Criteria for Entering a Contract with a Supplier or Source Selection

A Contract is a mutually binding agreement that enables a supplier to supply a specific item, materials, product or service with the assurance that the buyer will pay for it. A contract carries a legal relationship subject to enforcement in the court. The agreement may be simple or complex, usually reflecting the simplicity or complexity of the item to be supplied. In most situations as seen with organizations, they furnish the supplier with documented policies and procedures specifically defining the signatories required for such agreement on behalf of the organization, which is known as **delegation of procurement authority**. Contract for such business activity can also be called **an agreement, a subcontract, a purchase order, a memorandum of understanding, etc.** However, a procurement document are usually flexible in a way to accommodate additions, review, and approval, but the legal part of it means that it will be subjected to a more extensive approval process. In most situation, a primary focus of the review and approval process should be to ensure that the contract language describes the item to be provided or service to be rendered. And for public procurement, the review would require public review of the agreement.

There are specific standard that is required to finally choose a source for providing needed products or service to the organization. The criteria would require a non-bias provision that would be acceptable by standard, which includes:

- 1. Contract Negotiation:** This requires openness and understanding on the structure and requirements of the contract prior to the signing of the contract. With consideration that final contract technical language should reflect all understanding and agreement reached. The subject cover of the contract under negotiation would specifically include, but not restricted to, responsibilities and authorities, applicable terms and laws, technical and business management approaches, contract financing, and price. For instance, in a situation where items for procurement, contract negotiation may be an independent process with input such as open item list, or an output, such as memorandum of understanding.
- 2. Gauge for Weighting:** This is used for qualifying qualitative data to minimize the effect of personal bigotry, preconception and bias on source selection. For most system, it will involve:
 - a. Assigning numerical weight to each of the evaluating criteria
 - b. Rating the supplier on the bases of evaluation criteria
 - c. Multiplying the weights of the rated items
 - d. Adding all the results to ascertain each cumulative weight of the items
- 3. Screening:** this aspect require establishing minimum standards for measuring performance of one or more of the evaluated criteria.
- 4. Independent Estimates:** For most materials to be procured, the contract organization will be required to provide its own independent estimates as a standard for price presentation, and it is expected to have a notable difference from other estimates, as a check that the scope of work was not sufficiently evaluated. Or the potential supplier was not properly

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informed, or lacked the ability to respond to the SOW; such independent estimates are usually called ***should cost estimates***.

How to Administrate a Contract

Contract administration is the process of ensuring that suppliers' performance meets contractual requirements. For large operations with multiple items and service vendors, a key aspect of contract administration is managing the interface among the various providers. The legal nature of the contractual relationship make it necessary that the operation team be acutely aware of the legal implication of actions taken when administrating the contract. Contract administration includes application of the appropriate procurement management processes to the contractual relationship and integration of the output from these processes into the overall management procurement. This integration and coordination will often occur at multiple levels when there are multiple sellers and multiple products involved. Some of the procurement management processes that are required are:

1. Procurement plan execution: which mandates the vendor to supply at the appropriate time
2. Performance reporting: this require monitoring supply cost, schedule and technical performance at intervals
3. Quality control: this require specific indicators to watch at, and verify adequacy of suppliers product
4. Change control: this ensure that changes are properly approved and that all those with a need to know are timely informed of such changes.

Contract administration also has a financial management component. Payment terms should be defined within the contract and must involve a specific linkage between suppliers progress made and supplies compensation paid.

Requirements for Contract Administration

There are some basic ingredients that must be available for a contract to be administered:

1. Contract: The mutual agreement between the vendor and the buyer must be established, with the legal quality for enforcement within the competent court of jurisdiction.
2. Performance result: This is when the deliverables have been completed and which have not, to what extent are quality standard been meet, what cost have been incurred or committed, are collected as part of performance plan execution.
3. Variation or Change request: This may include modifications to the terms of the contract or to the description of the product, item or service to be rendered. If the vendor performance is unsatisfactory, then a decision to terminate the contract would also be handled as a change request. Contested changes, those where the vendor and the procurement management tram cannot agree on compensation, are defined within the contract
4. Vendors Invoice: This specify that the vendor must of necessity render or present invoice from time to time to request payment for the work done. Invoicing requirement including necessary supporting documentation, are defined within the contract.

Methods for Administrating Contract

Different techniques are open for organization to administrate their contract for procurement purposes. Here are some of the methods:

1. Contract Change control System: This stipulates the process by which a contract may be modified. It also includes paperwork, tracking system, dispute resolution procedures, and approval levels necessary for authorizing changes. The contract change control system should be integrated with the integrated change control system
2. Performance Reporting: This provides management with information about how effectively the vendor is achieving the contractual objectives. Contract performance reporting should be integrated with the integrated procurement performance reporting
3. Payment System: Payment to vendors are usually handled by the accounts payable system of the buying organization. In situation of high volume procurement plan with many or complex procurement requirements, the procurement department or team would develop

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its own system. In either case, the payment system must include appropriate review and approvals by the procurement department of management team

4. Correspondence: contract terms and conditions often require written documentation of certain aspect of buyer and seller communication, such as warning of unsatisfactory performance and contract changes or clarifications
5. Contract Change: Changes are feedback through the appropriate procurement processes or project planning processes, and the procurement plan or other relevant documentation is updated as appropriate
6. Payment Request: This assumes that the procurement department is using an external payment system. If the procurement department has its own internal system, then request would have been simple payment

Contract Closeout

This is similar to administrative closure, in that, it involves both product verification as to if performance was accurate and satisfactory, and administrative closeout as to updating the records to reflect final results and archiving of such information for future use. The contract terms and condition may prescribe specific procedures for contract closeout. Early termination of a contract is a special case of contract closeout.

Requirement for Contract Closeout

For a contract to be finally closed out, the contract documentation is very key. Contract documentation includes but not limited to, the contract itself along with all supporting schedules, requested and approved contract changes, any seller-developed technical documentation, seller performance report, financial documents such as invoices and payment records, and the results of any contract related inspections.

Methods for Contract Closeout

Each procurement department may adopt measures to use as method for closing out contract, as must as it is agreeable by both the seller and the buyer. However, the most professional method is known as **procurement audit**. This is a structured review of the procurement process from procurement planning through contract administration. The objective of procurement audit is to identify successes and failure that warrant transfer to other procurement items of a particular operation to another operation within the organization.

Contract File: A complete set of indexed records should be prepared for inclusion with the final procurement records

Formal Acceptance and Closure: The personnel or organization responsible for contract administration should provide the seller with written notice that the contract has been completed. Requirements for acceptance and closure are usually defined in the contract.

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