

Title of Submission

Changes in Purchasing and The Buyer-Supplier Relationship

Primary Author Name

Rebecca LaFlamme

E-mail

Rlaflamme82@yahoo.com

Educational Institution

University of Houston

APICS Terra Grande - Heartland District Chapter Affiliation

Houston Chapter

Changes in Purchasing and the Buyer-Supplier Relationship

Rebecca LaFlamme & Amy Sander

Rebecca LaFlamme is currently an undergraduate student in Operations Management at the University of Houston, Houston, TX. Houston Chapter
Full-Time Undergraduate

Amy Sander is currently an undergraduate student in Operations Management at the University of Houston, Houston, TX. Houston Chapter
Full-Time Undergraduate

amysander@ymail.com

Changes in Purchasing and the Buyer-Supplier Relationship

Abstract

This paper discusses how the business world is changing and how that affects the role of purchasing in companies. This in turn creates the need for changes in the relationship between Buyers and Suppliers. Examples of Wal-Mart and Toyota are used to show how these relationships work.

PURCHASING

In the past purchasing was considered a simple clerical or administrative function. The goal of the purchasing agent was to expedite orders as well as get the lowest price from the suppliers possible. Business is changing rapidly and along with this comes the need for changes in areas such as purchasing. Companies are requiring greater skill sets from the people they hire to put in these positions. Among these skills they are asking that their purchasing agents be proactive instead of reactive. The strategic importance of purchasing is being recognized by organizations now and they need for their agents to be able to think beyond the way things have always been done. These purchasing professionals are expected to come up with creative solutions to the new and interesting challenges that the world of business is faced with today.

Now that most companies have access to the same resources, they are realizing that they are competing supply chain to supply chain (10). This is why purchasing has become so important because it is being noticed how much of an impact it can have on a company's bottom line. What makes a company successful in the present time is how quickly they can get quality material and at what price. Two companies may make the same product but if one can get it made cheaper and faster than the other, then that will be the one who gains the market share. If a company manages to be first to market with their product they will maintain 40% to 60% of the marketshare even after their competitors have entered the market.

OUTSOURCING

One of the biggest driving forces behind the focus on purchasing is the switch from companies being vertically integrated to outsourcing. Outsourcing has become the preferred way of doing business because it allows companies to focus on what they do best (1). In the past companies wanted to do everything for themselves. They figured if they owned their means of supply, they would have more control and that things would work more efficiently. This way of thinking, known as Fordism, has been proven wrong in the past few decades. Companies are now recognizing that there are some things that they do better than others which are their core competencies and that is what they are concentrating on. They also see that even though there are other parts of their business that they do well, there is usually someone else who can do it better and cheaper. By utilizing these other companies and their areas of expertise, the real benefits of outsourcing are now being appreciated.

One of the main advantages of outsourcing is companies no longer have to make huge capital investments every time they choose to pursue a new product or new business venture. Instead of putting the time and money into new projects, these responsibilities can be outsourced to other organizations that already have the knowledge and capabilities to get the job done. Because these capabilities already exist within this organization they are able to provide the product or service at a much cheaper price than what it would have cost the original company to do it themselves.

With any change there will be disadvantages along with the advantages. The biggest disadvantage of outsourcing is the loss of control. While these companies gain the benefits of

using someone else's expertise, they become reliant on them and that can create problems. Suppliers have to be carefully chosen to make sure they have the proper resources and capabilities to maintain a steady flow of goods and services (13). Stock outs or defects in final products due to bad material will be blamed on the buyer and not the supplier. This is why it is so important when choosing who a company does business with to make sure they have the same standards of business practices (6). A great example of how outsourcing can cause a company problems is what Mattel went through with one of their suppliers in China. Mattel had to make a huge recall on its toys because they found out there was lead in the paint used on them. This of course had a huge impact on how customers viewed Mattel (2). This was a company that people trusted to make safe toys for their children and now because of one of their suppliers they had put many children in danger. It is because of problems such as this that companies are paying more attention to who they do business with.

The move to outsourcing has caused materials costs to rise significantly. In a Swedish study it was found that on average, purchasing accounted for over 50% of total cost. Of course this does not apply to all industries. The number is lower for industries such as gas and electric, as well as food manufacturing. Even though their percentage of purchased goods and services is lower it is consistent with the trend because it still continues to increase every year. With materials costs being such a big part of companies spending, purchasing is now more of a strategic decision instead of tactical. In many cases it is the deciding factor in how successful a company becomes.

As a result of all the changes taking place in the way companies do business, what used to be known as purchasing is now being called supply management. This concept looks at materials management as more than order placing and expediting. It calls upon the ability of the purchasing professional to be able to form and maintain relationships with suppliers. As vertical integration becomes a thing of the past, suppliers become a more integral part of all aspects of a company's operations.

NEW RELATIONSHIPS

Previously the buyer-supplier relationship was handled on a transactional basis in most companies. There was no sense of partnership or working together to make something happen. The buyer was focused on getting the cheapest price, usually making the suppliers give bids to see who would come out the lowest. At the same time the supplier was trying to get a high enough price to cover their costs as well as make a profit. This type of transactional relationship made for a zero-sum game between the two parties, which means that for one side to win the other would have to lose. It was very rare for both the buyer and supplier to be happy when the deal was done(4).

These two sides working against each other made for a very adversarial relationship. There was absolutely no trust or loyalty. The buyer did not trust the supplier to deliver the right goods in the specified time frame. Buyers would generally have many suppliers they used and if at any time one particular supplier would not give them the price they wanted they would simply use another from their database. Suppliers also did not trust the buyer to give them

return business so they did not go out of their way to make concessions for them in hopes they would keep using them(3).

Instead of working against each other, buyers and suppliers are now realizing the benefits that come with collaboration. The two sides are now beginning to work with each other to form supply networks. Cross functional teams are becoming a very popular tool used to determine which supplier should be selected. By having people involved from different departments of an organization, every aspect of the design and production of a product can be considered(7). This will tell the company what services and capabilities they should be looking for when choosing suppliers. The reason this is so important is because the relationships between buyers and suppliers is now a long term commitment and they are now being nurtured instead of discarded.

The ultimate in buyer-supplier relationships is the supply alliance. In the past the majority of business transactions were done at arms length. In place of this, companies are now embracing each other and working together, almost as one entity, to a mutually beneficial goal. The key to this kind of relationship working is institutional trust. The communication between the two sides is completely open and both parties' best interests are looked after. The level of trust is so high that the suppliers are willing to make investments in equipment and technology that are specific to their customer's needs. This can now be done because the supplier knows that as their customer's business improves so will theirs(4).

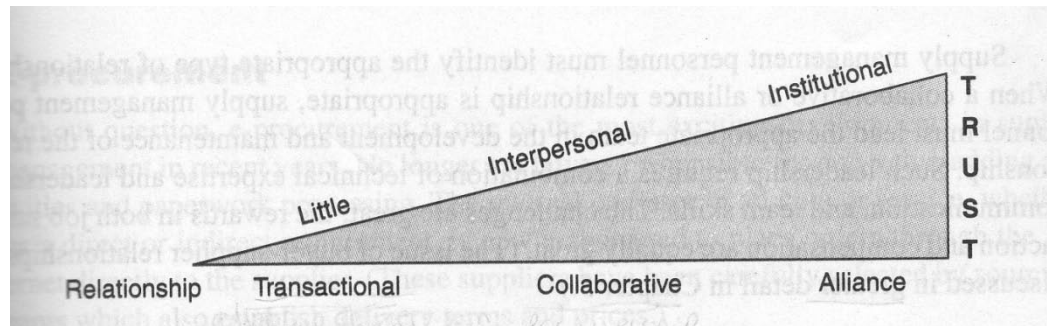


Figure 1

This figure shows that the more collaboration there is between buyers and supplier, the more trust will be needed.

While supply alliances, today seem to be the best way to do business, they are not suitable for every company and its market place. One example where supply alliances are not appropriate and are never used is in the commodities market. Commodity items are your basic day to day items such as paper, milk, crude oil, sugar, and etc. The items are pretty much the same no matter who makes them. Commodity items have a fairly stable demand and can be purchased from hundreds of suppliers. With these items, companies only need to have a purely transactional relationship with their suppliers, one that is focused solely on price. Since there are hundreds of suppliers out there, companies shop around for the best price; this allows them to save money. It is not worth the time and effort to form a supply alliance with commodity suppliers because if they were to go out of business for example, there is another supplier waiting with the same product around the same price.

WAL-MART

Wal-Mart is the largest retailer in the world. They are a perfect example of how supply alliances do not work for every situation. Some people may argue that Wal-Mart has good relationships with their suppliers but when doing the research, I found that this is not true.

Wal-Mart is an incredibly powerful company. The sole purpose of their business is to bring consumers the lowest possible prices on products. In order to do this, Wal-Mart continues to put obscene amounts of pressure on all their suppliers, forcing them to lower their prices every year. They are strictly price focused. If suppliers don't lower their prices to meet Wal-Mart's price, then they will simply get another supplier, and stop doing business with you. Wal-Mart may go to a competitor and have them match the price or they make take the business overseas and import it. Wal-Mart will do whatever it takes to get the lowest price for the consumer, even at the expense of the supplier (8).

Charles Fishman's article, "The Wal-Mart You Don't Know" talk about the "squeeze" Wal-Mart puts on all of it's suppliers in order to get the lowest price possible. One example he writes about is Vlastic's gallon-sized jar of pickles. When it first came out, the jar was priced at over three dollars and sold successfully. Then Wal-Mart took it further and wanted to offer it to consumers for under three dollars; they priced the jar for \$2.97. Consumers went crazy over this; a gallon jar of Vlastic pickles for under three dollars. While sales increased rapidly, Vlastic wasn't making any profit on the item. They were only making a cent or two on each jar sold. It even started hurting the other Vlastic pickle items because shoppers from other stores were going to Wal-Mart just to purchase the gallon-sized jar (8).

Vlasic shortly went to Wal-Mart to see if they would increase the jar of pickles just slightly so that they would make some kind of profit. Wal-Mart turned them down without a second thought. Wal-Mart even told them that if they won't sell the pickles for \$2.97, then they would go to a competitor and ask them, and quit doing business with Vlasic altogether. Vlasic soon filed for bankruptcy; it is not fully determined if the gallon-size of pickles had a direct effect on that (8).

The article also talks about a project study that Bain & Co., a global management firm, did on Wal-Mart trying to find out if companies actually have "healthy relationships with them". They found that when negotiating prices with suppliers, if Wal-Mart does not like the price then they will tell the supplier, "Here's the price you gave me. Here's what I can get a competitor's product for. Here's what I can get a private-label version for. I want to see a better value that I can bring to my shopper this year. Or else I'm going to use that shelf space differently" (8, pg. 3). Basically this is a direct threat from Wal-Mart to the suppliers, and they have the power to do so.

Carey, a partner at Bain & Co., gives the example of his friend in the umbrella business that once supplied for Wal-Mart. One year the umbrella owner went to Wal-Mart and requested a five percent increase in sales price and Wal-Mart turned him down. The owner then lowered his request to a small two percent increase and Wal-Mart denied his request completely and even quit doing business with him altogether. They told him that they would go with a Chinese manufacturer which was incredibly cheaper than him (8).

It is important to note that these examples come from companies that no longer do business with Wal-Mart. The article discusses that when asking companies that currently work supply for Wal-Mart about their relationship, most would say it is great one, if they said anything at all. A lot of companies refused to even discuss Wal-Mart on any level. Just by refusing to talk, it is easy to grasp how powerful Wal-Mart is. Companies do not want to chance saying anything that could be taken negatively if Wal-Mart heard about it because they can stop doing business with any supplier at the drop of a hat. Most companies cannot afford to lose their market share they get from Wal-Mart shoppers. It's hard to work with Wal-Mart, but it's hard not to work with them at the same time (8).

TOYOTA

Toyota Motor Corporation is a perfect example of how a company can be extremely successful when forming strong alliance relationships with their suppliers. The Japanese term keiretsu, meaning a network of businesses that own stake in one another as a means of mutual security, is something that Toyota lives and breathes on a daily basis. Toyota realized the importance of supplier relationship when they first started and they have maintained a keiretsu still to this day.

In Lucia Ciferri's article, she talks about how Toyota is open to work with any supplier as long as they are able to meet the following criteria:

1. Quality
2. Technological capabilities
3. Ability to deliver the required quantities on time

4. Cost

While quality can easily be interpreted differently among companies, Toyota's quality standard is quite high. In fact, companies must meet certain ISO standards in order to do business. Toyota's individual standards for suppliers is even higher than the ISO standards, which forces companies to really improve their products and processes if they want to do business with them (5).

In the book, Collaborative Advantage: Winning Through Extended Enterprise Supplier Networks, Jeffrey H. Dryer writes about how Toyota has been so successful. He states that the key to Toyota's success "is the practice of dedicating supplier assets to the customer" (7, pg. 41). Toyota does this several ways including locating plants near the customers, sending its own engineers to work at the customer's site, and investing in customized physical assets. Because Toyota and the customer are sharing information and technology, they both benefit. Information is power and when shared, companies can grow together and become more efficient in time. They continually improve this way.

By locating facilities close to one another, Toyota decrease inventory costs, focusing that money on product development. In fact one of the things that makes Toyota so successful today is their Just In Time Inventory policy. Toyota makes sure that all of its suppliers' plants are located extremely close to one another so that inventory comes in only when they need it. It goes straight to the production line, and does not have to be stored anywhere. On average, the suppliers make eight just in time deliveries to Toyota's assembly plants everyday (7).

A PORTFOLIO APPROACH

One of the major challenges companies face is deciding what kind of relationship they should have with their suppliers. Every company is different in the nature of their business and will most likely have different relationships with many of their suppliers. This can be illustrated with the portfolio approach. The portfolio approach is a theory that states, “no single approach to relationship management is inherently superior” (4 pg. 92). Bensaou says that “successful supply chain management requires the efficient management of a portfolio of relationships”. Bensaou even goes further in that every company, when deciding which relationship style to adopt, should consider these factors: the product exchanged and its technology, the competitive conditions in the upstream market, and the capabilities of the suppliers available (4).

Although the trend seems to be moving towards building strong supply alliances, companies should not do this automatically. Each company needs to assess each of their suppliers and decide if a supply alliance would be appropriate. An alliance relationship takes much time and energy to form and should only be done if both the company and supplier benefit from the relationship.

REFERENCES

MLA

1. Axelsson, Bjorn. Frank Rozemeijer. Finn Wynstra. Developing Sourcing Capabilites West Sussex: John Wiley & Sons Ltd., 2005
2. Barboza, David. "Scandal and Suicide in China: A Dark Side of Toys" Nytimes.com August, 2007. April 2009. < http://www.nytimes.com/2007/08/23/business/worldbusiness/23suicide.html?_r=1>
3. Blanchard, David. "How to Sustain Successful Buyer/Supplier Partnerships" Industryweek.com December, 2007.
<http://www.industryweek.com/articles/how_to_sustain_successful_supplier/buyer_partnerships_15341.aspx>
4. Burt, David N., Dubler, Donald W., and Starling, Stephen L. World Class Supply Management, Seventh Edition. New Delhi. Tata McGraw-Hill Publishing Company Limited. 2003.
5. Ciferri, Luca. "Toyota says it's open to 'any' supplier". Automotive News Europe. Vol.12, Issue 7. April 2007. April 2009. Toyota says it's open to 'any' supplier..
6. Cox, Andrew. Chris Lonsdale. Joe Sanderson. Glyn Watson. Business Relationships For Competitive Advantage New York: Palgrave Macmillan, 2004.
7. Dryer, Jeffrey H. Collaborative Advantage: Winning Through Extended Enterprise Supplier Networks. Oxford University Press, Incorporated. 2000

8. Fishman, Charles. "The Wal-Mart You Don't Know". Fastcompamy.com. December 2007. April 2009. <<http://www.fastcompany.com/magazine/77/walmart.html>>.
9. Gadde, Lars-Erik., Hakan Hakansson., Supply Network Strategies . West Sussex: John Wiley & Sons Ltd, 2001.
10. Heinrich, Claus. Bob Betts. Adapt or Die : John Wiley & Sons, Inc., 2003.
11. Poirier, Charles. Advanced Supply Chain Management San Francisco: Berrett-Koehler Publishers, Inc., 1999.
12. Quayle, Michael. Purchasing and Supply Chain Management: Strategies and Realities. Hershey: Idea Group Publishing, 2006.
13. Schary, Philip. Tage Skjott-Larsen. Managing the Global Supply Chain Copenhagen: Copenhagen Business School Press, 2001.