



Certified Purchasing and Material  
Management Sample Material  
VS-1260

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## 1. PURCHASE MANAGEMENT

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Purchasing activity is an integral and incessant activity of every business. Many flourishing organizations regard it as a key function and thus have a dedicated purchase department to take care of the purchase activities. The prime objective is to clearly justify its separate existence. Further, since purchasing is a part of the total management activities, it should ensure that its objectives are in sync with the organizational objectives. Identifying objectives assists the imaginative personnel in enhancing their efforts to attain these objectives economically and efficiently. These objectives are established by the purchasing department head in consultation with the top level of management or as per the policies set by the management.

The primary goal of the purchasing organization is to purchase the right item or service, in the right quantity, at the right price, and at the right time. An abundance of competitors and seasoned customers demand higher quality, faster delivery, and products and services customized to their needs, at the lowest total cost. These demands are made at an even greater speed because of the influx of technology and social media into business-to-business applications. Information and data flow between supply chain members are increasing, making it challenging for organizations to continuously adapt to the ever-changing needs of the customer.

### Purchase Management History

| Period                 | Status   |
|------------------------|--|
| Late 1890s             | Purchasing rarely used as a different department except in the railroad.   |
| Early 1900s            | Purchasing considered clerical work.   |
| World War I and II     | Purchasing function increased in importance due to the importance of obtaining raw materials, services, and supplies to keep the mines and factories running.  |
| 1950s and 1960s        | Continued to gain stature, processes more refined, and more trained professionals. Still considered order placing clerical in a staff-support position.  |
| Late 1960s-early 1970s | Integrated materials systems introduced, materials became part of strategic planning, and importance of department increased.  |
| 1970s                  | Oil embargo and shortages of basic raw materials turned the focus of the business world to purchasing.   |
| 1980s                  | Advent of just-in-time with an emphasis on inventory control and supplier quality; quantity, timing, and dependability made purchasing a cornerstone of competitive advantage.   |
| Early 1990s            | Value proposition of purchasing continued to increase; cost-savings became the buzzword.   |
| Late 1990s             | Purchasing evolved into strategic sourcing, contracts were more long term, and supplier relationship building and supplier relationship management started.  |
| 2000s                  | Purchasing shifted its myopic focus on cost to much broader terms. Some of the widely used developments: spend analysis, low-cost country sourcing, procurement technology evolved (ERP, e-sourcing), procurement outsourcing evolved (P2P), total cost of ownership, data mining and benchmarking, and lean purchasing. |

Globalization has forced companies to improve their internal processes, such as supply management, to remain successful. The level of competition in the marketplace expanded to include both domestic and international markets. Purchasers no longer discuss “lowest price” but share information, collaborate, and talk to their suppliers about total costs, life-cycle costs, and cost reductions. This requires a focus on process improvements instead of short-term relationships and price reductions.

### 1.1. Objectives of Purchasing

Following are the objectives of purchasing:

- ✓ To maintain continuity in supply
- ✓ To maintain quality standards
- ✓ To avoid duplication, wastage and obsolescence
- ✓ To sustain organization’s competitive position
- ✓ To maintain good image of the organization
- ✓ To develop alternate sources of supply

**To maintain continuity in supply** - The purchasing function needs to ascertain that the materials, supplies and equipment are available in continuity, to avoid any disruption in production and maintain a production schedule. This also requires investments to be made in reserve inventories. The efficiency though can only be achieved if these factors are properly balanced that is dependent on experience, assessment of planned activities and activities forming part of purchasing authority.

**To maintain quality standards** - The purchasing function should ascertain that the purchased materials should be of desired quality such that the goods can be purchased as per specifications and quality standards are maintained.

**To avoid duplication, wastage and obsolescence** - The purchasing department head should possess accurate knowledge of items in hand and material requirements for a set period of time, to take informed decisions on both long range as well as short range plans. This is very important to avoid any duplication, wastage and obsolescence of the items purchased.

**To sustain organization’s competitive position** - The purchasing authority is responsible for evaluating his specifications on purchasing the right material. This will help ensure that the quality standards maintained are neither higher nor lower when compared to those of arch rivals as well as to maintain the goodwill of the organization in the industry.

**To maintain good image of the organization** - The purchasing agent should build a good image of the organization before the vendors for smooth functioning of the purchasing operation as well as to explore new areas and materials, apart from reducing their costs and enhancing product quality.

**To develop alternate sources of supply** - The purchasing department should identify alternate sources of supply to increase the bargaining power of the buyer and cut down on the purchase expenditure. This also eases down the pressure when a particular supplier fails to deliver the required items; the same can be sourced from the selected alternate suppliers.

## 1.2. Functions and responsibilities of Purchase Department

The functions and responsibilities of the purchasing department can be broadly outlined as below:

- ✓ To make the materials, supplies and equipment available for the organization at minimal costs, such that it leads to maximum productivity and subsequent profitability of business operations.
- ✓ To make sure that there is continual flow of production with undisrupted supply of raw materials, component parts, supplies, tools, equipment, etc. with repairs and maintenance services.
- ✓ To enhance the asset turnover ratio, such that the investments made in fixed assets as well as inventories are minimal with respect to the corresponding volume of sales. This will also increase the profitability of the organization.
- ✓ To identify alternate sources of supply, increase the bargaining power of the buyer and ensure cost minimization and increased ability to meet the emergencies.
- ✓ To establish good relations with the suppliers, which helps in communicating a favourable image in the business circles, and these are often useful when it comes to changing reasonable prices, preferential material allocation during shortages, intimation about foreseen shortages, details about the newly established substitute, outstanding payments during temporary liquidity crisis, etc.
- ✓ To attain maximum integrity with other organizational departments, including production department or material specs, flow and recommended supplies of certain items, etc., engineering department for purchasing tools, machines and equipment, marketing department for sales forecasts and impact of input quality on output quality, finance department to maintain levels of materials, scheduling investments, etc., and personnel department to man and develop personnel, maintain supplier relationships, etc.
- ✓ To train personnel and develop them and ensure management succession with contented workforce.
- ✓ To ensure efficient recordkeeping and management reporting, such that paper processing is standardized and recordkeeping is maintained.
- ✓ In addition to the above, the management is also concerned if the following aspects are in place to give the key policies a concrete shape
  - ✓ Quantity and value of the items purchased, segregated by raw materials, spares, component parts, machines and equipment, supplies, etc
  - ✓ Departmental costs under the relevant heads of the expenditure
  - ✓ Work analysis of the purchase department
  - ✓ Details about cash discount and quantity discount earned and lost
  - ✓ Price trend in the ensuing period and its impact on inventory costs
  - ✓ Planning on material availability and strategy development as planned
  - ✓ Details about new materials and processes that can reduce manufacturing costs
  - ✓ Identification of new alternate sources of supply

## 1.3. Methods of Purchasing

There are five essential methods of purchasing:

- ✓ Bulk Purchasing
- ✓ Hand to Mouth Purchasing
- ✓ Speculative Purchasing

- ✓ Blanket Purchasing
- ✓ Reciprocate Purchasing

**Bulk Purchasing** - Bulk Purchasing is the most economical form of purchasing. But at the same time, it involves more capital investment of overstocking and high storage costs owing to likely damages. Bulk purchasing is an ideal option for making large quantity of purchase for the future.

**Hand to Mouth Purchasing** - This purchasing is also widely known as Zero Stock Buying, which means that there are no purchase transactions done until a demand arises, and accordingly the purchase of quantities is decided. This method is mostly used in case of emergencies, or to the goods used occasionally and not taken into stock. Further, using the method avoids any blockage of capital investment in materials, carrying costs, obsolescence and wastage of materials. However, the only drawback in this method is that there is fear of production halts due to paucity of materials, or the materials then need to be procured at higher costs.

**Speculative Purchasing** - In cases when the manufacturers prefer to purchase materials in large quantities than required in manufacturing process, it is planned such that the surplus can then be sold off at higher prices for earning profits. Speculative purchasing is popular in cases of extremely low prices when it is expected that these materials will fetch better prices in the upcoming period. While one can benefit from speculative purchasing method that it can give you huge speculative profits, it also blocks large amount of capital and you need large storage space and as such, there are risks of obsolescence, etc.

**Blanket Purchasing** - The method involves ordering items of same group under one category; the blanket purchase orders can be utilized for purchasing frequently purchasing items or services, and have been designed such to effectuate the procurement processes.

**Reciprocate Purchasing** - In this form of purchasing, an arrangement is entered into between two or more organizations that purchase each other's goods and services.

### 1.4. Purchase Organization Structure

The purchasing function of any company is vitally important to the success of that company. By negotiating with vendors, a purchasing department can get the best quality items, at the best price, at the right delivery time. In this way, a company can ensure that they have the parts available for their manufacturing process, which in turn allows the production team to produce and deliver quality items to the customer.

The way in which a purchasing department is structured is directly dependent on the way in which the company operates. Having a purchasing organization structured in the wrong manner can lead to higher costs for materials and inconsistencies for the production of finished goods, which can lead to degradation in customer satisfaction.

#### **Small Business**

For small businesses, the purchasing of materials is as important as it is for large companies. A small business operates in a lean manner, and the purchasing process may be simple, but still has to operate successfully. A small business may have one purchasing professional who has to procure

all the items required for the business. The advantage of a single purchasing professional is that they will usually have a personal relationship with vendors and can act quickly when issues arise.

However, they need to ensure that materials arrive when they are required and at the correct price.

As businesses grow, the single purchasing professional can easily become overwhelmed and this can lead to their inability to keep on top of vendors and deliveries. It is important for small businesses to understand that a growing company needs to ensure that their purchasing department grows in step to ensure that they maintain the efficiencies that had been created.

### Centralized Purchasing

Larger companies often adopt a centralized purchasing structure with all the purchasing staff reporting to purchasing executive. The centralized purchasing organization will accommodate the purchasing requirements for the whole company. For example, if a company has seven plants across the US, the central purchasing organization will be located in one location, and purchase items for all seven plants.

There are a number of reasons why companies would choose this type of purchasing structure. By having a single purchasing organization, the company is able to leverage the total spends of the company when negotiating with vendors. This should allow the purchasing department to ascertain the best price and conditions from vendors by offering them a commitment to buy in larger volumes.

Centralized purchasing organizations also allow purchasing professionals to specialize in one area. For example, a purchasing clerk could work with vendors who provide steel products, whereas if they were in a smaller purchasing department they would have to work with vendors from many industries.

Companies often like centralized purchasing departments as it gives them a higher degree of control over the purchasing process.

By having the purchasing dispersed across the organization, then there would be a far greater number of personnel involved in the process and less control of the purchasing process.

### Decentralized Purchasing

Organizations with many locations can adopt a decentralized purchasing model. This allows each facility or a group of facilities to carry out their own purchasing. This purchasing model can be successful where the culture of the organization is such that each location acts as its own profit center, or has a business that is different from other locations. For companies that have acquired businesses that may not be akin to their core business, then the decentralized purchasing structure would be more appropriate. Local purchasing organizations will often operate similarly to the small business model where they will have closer ties to local vendors and be able to react quickly when required.

Where facilities require the delivery of items at a moment's notice, the centralized purchasing model is not appropriate. If a stock out is imminent, and manufacturing will be halted, then a local

vendor can often deliver the same day, whereas centralized purchasing will probably deal with a national vendor who will not be able to offer the same response.

Many companies have tried to adopt a mix of centralized and decentralized purchasing, where facilities have the purchasing responsibility for certain critical production items, but the central purchasing organization has the task of purchasing non-critical items.

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Contact us at :

**Vskills**

011-473 44 723 or [info@vskills.in](mailto:info@vskills.in)

[www.vskills.com](http://www.vskills.com)