UNIT 6 VENDOR NETWORK

Objectives

After reading this unit, you would be able to:

- discuss selection of suppliers for developing a supply chain network;
- describe decisions & define problems in supply chain Network;
- discuss supplier development models;
- discuss supllier networking; and
- highligh the importance of business network.

Structure

6.1 INTRODUCTION

The search for competitive differentiation has led firms to move from their predominantly cost-based focus of the 1950-1970s to the one based on both quality and cost during the 1990s. This change has created a paradigm shift in business practice from the "producer-driven orientation" of the past to today's "customer-driven orientation". The competitive environment of the present is characterized by continual and unpredictable changes in market demand, in terms of both product specifications and quantity. This has also led to the need for manufacturers to have enough capacity to produce a broad range of high-quality products at low cost with short lead times, and to build these products in an efficient way to suit the specifications of individual customer.

It may often be the case that no single organization can respond quickly enough to the changing markets in a competitive environment of this type. Furthermore, large organizations are often very complex and slow to move, while smaller organizations suffer from a scarcity of resources. These conditions favour the emergence of new forms of dynamic network to connect manufacturers. Such a network develops on the basis of temporary alliances with other parties. These alliances are based on the core competencies of the various suppliers to create a supply chain that is highly responsive and flexible at responding to customer orders. To ensure such flexibility, the supply chain is considered to be temporary and its precise form is dependent on the demands of the market. By developing collaborations of this kind, manufacturers can increase their level of expertise and minimize the risk of investment.

6.2 SELECTION OF SUPPLIERS: A KEY ISSUE

One of the key issues in developing such a supply chain network is the selection of the suppliers. Sound selection is crucial since the performance of the chain depends on every single organization involved. Many factors are usually taken into account in the supplier selection process. Samadhi and Hoang (1998) have suggested a three-stage procedure for evaluating supplier compatibility, starting with abstract and strategic factors, moving through their attributes in terms of manufacturing, and ending with logistical factors. Talluri et al. (1999) have given a framework for the design of a design value chain network with a two-stage procedure that combines data envelopment analysis (DEA) and goal-programming techniques. In other work, De Boer et al.(1998) have proposed the outranking methods to support the selection of suppliers. These methods are based on multi-criteria factors. In all of this research, by De Boer et al. (1998), Samadhi and Hoang (1998), and Talluri et al. (1999), the strongest emphasis is placed on the strategic factors that need to be considered in selecting suppliers.

On the other hand, some efforts have been made to address operational factors. D'Amours et al. (1996) have developed a model for the price-based planning and scheduling of actions to do with multiple products to create a symbiotic manufacturing network. In that research, they have assumed a set of bids from potential suppliers as given. The impact of information sharing on the development of networked manufacturing has been considered in subsequent work by D'Amours et al. (1999). Li and O'Brien (1999) have developed a two-stage model for the design of an efficient supply chain. It focuses on analyzing the impact of three possible manufacturing strategies, the make-to-order (MTO), make-from-stock (MFS), and make-to-stock (MTS) strategies.

6.3 OVERVIEW OF DECISIONS AND PROBLEM DEFINITION IN SUPPLY CHAIN NETWORK

The objective of the supply chain network is to minimize the end customer's total level of dissatisfaction, composed of price and delivery lead time.

As Samadhi and Hoang (1998) have explained, there will be no collaboration if there is no one to initiate it. The suppliers to be selected to participate in the collaboration must also be compatible with the initiator(s). In this research, a set of manufacturers is given. The manufacturing company that receives the prospective order directly from the ends customer acts as the initiator. This manufacturer is then at the chain level decision of this supply chain network. The other manufacturers respond to the initiator's lower-level product-procurement requests. In this research we use the term "supplier" to describe any manufacturer playing a lower-level supporting role. After receiving a prospective order, the initiating manufacturing company sets the goals for the potential suppliers at each stage of the supply chain. These goals are: due date for delivery (d), quantity required (q), and required unit price (r).

The potential suppliers then play their part in achieving these goals by applying the operational-level model to optimize their manufacturing and logistical activities to determine the order quantity(Q_o^{min}). After receiving responses from all potential suppliers at each lower stage of the chain, the initiating manufacturing company uses the chain-level model in the final stage to determine the order quantity for each selected supplier (partner), and estimates the performance of the supply chain. Fig.6.1 gives an overview of the problem situation.

Decisions at the operational level are thus concerned with the optimizing the manufacturing and logistical activities of each potential supplier to meet the customer’s requirements. Chain-level decisions then deal with evaluating each bid from the potential suppliers and determining the final configuration of the supply chain.

Figure 6.1: Overview of the problem situation

Table 6.1: Different flows and decision variables in supply chain network

Flow 1: Invitation to bid	**Flow 2: Suppliers bid**
Delivery due-data(*d*) Order quantity (*q*) Target of unit price (*r*)	Order quantity supplier *i* has offered to provide at stage *n* (q_{oin}) Minimum order quantity required of supplier *i* at stage Delivery lead time at order quantity supplier *i* has offered to provide at stage
Flow 3: Results of bid Order quantity allocated for production by supplier *i* at stage *n* for delivery to supplier *j* at stage *n-1* ($Q_{ain,jn-1}$)	Delivery lead time at minimum order quantity required of supplier *i* at stage Price for order quantity supplier *i* has offered to provide at stage
Flow 4: Physical flow	Price for minimum order quantity required by supplier *I* at stage

Activity 1

Make an internet search on the state-of-the-art supply chain network. Make also a list of available analytical models of the supplier selection process in this context.

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6.4 PURCHASING PERFORMANCE AND SUPPLIER DEVELOPMENT

Facing increasingly competitive challenges, many organizations view supplier performance as an important contributor to their competitive advantage. They work closely with suppliers and expect to improve performance and capabilities by engaging supplier development programs.

It has been reported that such programs have been extensively implemented in western countries. However, developing the supplier has also provided quite challenging. A conceptual model for guiding the implementation of supplier development program was proposed by Hahn et al. However, it was not empirically tested. Some perceived critical elements of supplier development were explored by Krause and Ellram, and some "antecedents" of involvement in supplier development program were also identified by Krause. But these factors were not linked with purchasing performance. In this body of literature, few empirical research studies have been conducted to examine the factors which are critical to the success of the approach.

6.5 SUPPLIER DEVELOPMENT MODELS: A REVIEW OF LITERATURE

Hahn et al. developed a conceptual model that described the organizational decision process associated with a supplier development program. This model was established just on the basis of experience of several companies actively engaged in such a program. Krause and Ellram conducted a survey of 96 US purchasing firms and found that the majority of buying firms involved in supplier development perceived their suppliers as partners and placed a greater emphasis on some critical elements than those not involved in such programs. These critical factors included two-way communication, top management involvement, cross-functional teams and larger purchasing power.

Krause developed reliable and valid measures of the factors influencing supplier development and tested a structural model that postulated the interrelationship among these factors. The buying firm's propensity to engage in supplier development may be affected by its perception of supplier commitment, its expectation of relationship continuity, and effective buyer-supplier communication.

The studies in this field provide some useful insights for managers who wish to invest their time and resources to improve supplier's performance. Supplier development stresses that direct supplier development plays a critical role in driving performance improvement in purchasing and contributes strategically to overall organizational effectiveness.

6.6 INFLUENCING FACTORS OF SUPPLIER DEVELOPMENT

The important elements of supplier development may be identified from the buying firm's perspective. The following factors are worth mentioning:

i) **Long-term Strategic Gal:** Supplier development efforts should focus on developing supplier future capabilities in technology and product development rather than focusing only on current quality and cost. The clarity of long-term strategic goals is the key to the success of supplier development programme.

ii) **Effective Communication:** Open and frequent communication between buying firm personnel and their suppliers is identified as a key approach in motivating suppliers. Early involvement and open channels of communication increase both parties' understanding and encourage problem solving between both parties.

iii) **Partnership Strategy:** The majority of buying firms involved in supplier development may perceive their suppliers as partners. Adopting a partnership strategy means that a buying firm pursues a long-term relationship with suppliers and they would like to show their commitment. Without buyer's commitment, the suppliers may be unwilling to make changes in their operation to accommodate and desires of that.

iv) **Top Management Support:** It is top management who recognizes the need to initiate a supplier development programme based on the firm's competitive strategy. Purchasing management needs the encouragement and support from top management to expend their resources within a supplier's operation.

v) **Supplier Evaluation:** Not all selected suppliers qualify for development assistance and a buying firm must carefully identify where to focus its supplier development efforts. Supplier evaluation results can provide valuable information about general areas of weakness where performance improvements are required.

vi) **Direct Supplier Development:** In order to pursue excellence and develop best practices, the suppliers need the encouragement or expertise of their buyers. Direct supplier development activities include providing support personnel, capital, equipment, technology, or direct involvement with suppliers in identifying and eliminating non-value or duplicate costs, processes and time. These assistances from the buyers can accelerate supplier capability improvement greatly.

vii) **Perception on Supplier's Strategic Objective:** Supplier development requires a mutual recognition by the buyer and supplier of the need for continuous performance improvement. Supplier development would not work if the supplier does not have a compatible strategic objective with that of customer.

Activity 2

Based on your library search, make a comprehensive write up on different types of vendor development practices.

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6.7 SUPPLIER NETWORKING

In many business environments, networking is almost an inevitable solution to help companies respond fast to market changes. Though networking companies may deepen their relationship with partners and thus become more dependent on each other. The key success factors in networking, and the motives for entering into a partnership or alliance form the basis for the development of network arrangements. Opportunities like reduced transactions costs, ability to concentrate on core skills, access to key technologies, and risk sharing among partners give direction for the development process.

6.8 IMPORTANCE OF BUSINESS NETWORKS

Business networks are defined as a long-term, purposeful arrangements among organizations that allow the operating organizations to get long-term sustainable competitive advantage. In strategic networks a lot of weight is put on the reciprocity of the relations. The individual companies operating in the network are dependent on the resources of the other network companies, and the possibilities of the individual organization to utilize these resources are determined by their place in the network. Network arrangements result from strategic collaboration between more than two independent companies with the aim of pursuing economic advantages. A network can be defined as a specific type of relation linking a defined set of persons, objects or events. Japanese companies have organized their suppliers into hierarchies: first-tier or primary suppliers provide systems rather than components. This trend reduces the number of first-tier suppliers and also makes the buying company more dependent on the suppliers. The primary tool employed by the Japanese to implement closer supplier co-ordination and individual supplier development is cross-exchange of staff between buyers and suppliers. The integrated procurement strategy should include such issues as: value chain positioning, environmental analysis, objective setting, organization structuring, strategic make or outsource decisions (which should include the strategic assessment of what is a firm's core competency), choice of different strategies (when to use competitive, partnership or network strategy) and the links between company level strategy and other functional strategies.

In general, through networking, companies aim at reducing financial and technological risks and improving their competitive advantage through deeper specialization. Further challenges are caused by such factors as shortening turnaround times, fast developing technologies, and the globalization trend.

6.9 PROBLEMS AND RISKS IN VENDOR NETWORKING

The network-related problems and risk are connected mainly to the network's resistance towards changes, new technologies, practices and members, as well as to problems and risks that may arise in network management or the setting up of appropriate development activities. Increasing requirements for communication and co-operation activities also add claims for more efficient information systems, openness, trust, and production systems. There may also arise problems with information transfer.

A business network is comprised of several tiers of suppliers. The first tier suppliers, which work for the OEM company, have again their suppliers. Thus, like the buying companies, they need to take the responsibility of the work of the suppliers against that of their customer, the OEM. The difference is the scale of deliveries. The relationship between the primary suppliers and the OEM has with its customers. As the suppliers make investments to satisfy the main contractor's anticipated demand they also carry part of the demand risk of the main contractor. The main factor affecting the risks of the supplier is being strongly dependable on one customer or operating in many networks. The types of problems and risks usually encountered are as follows:

i) **Too Low or Inappropriate Demand:** The demand problems may be caused by a decreased demand of end products due to economical trends or change of product generation. It is also possible that the universal demand does not decrease but the OEM loses its position in the market. Furthermore, the success of the OEM does not guarantee the success of the supplier; it may become replaced by competitors in their market place if the competitors can offer better services to the OEM.

ii) **Problem in Fulfilling Customer Deliveries:** In hierarchic network delivery, each acting company is responsible of its deliveries to the customer at the next hierarchy level. Thus, each company must control not only their own work but also the work of their subcontractors. As the price is most often fixed before the delivery, the main items to be managed are quality and the time. As the development of networking has led to an increase in the size of the responsibilities of the primary suppliers, they quite often have to face new management challenges as well. These challenges are mainly related to the demand fluctuations and flexibility of supply. Too high demand may also be risky, if companies are not able to adapt their operations to the growth.

iii) **Cost Management and Pricing:** Having demand and fulfilling deliveries is not enough for a company to be profitable. It must also be able to manage its costs, both fixed and variable. The increasing responsibilities in many cases also require growing investments; thus risks of investments often increase. In high demand business cycles, companies may endanger their ability to control their cost structures and investments.

iv) **Weaknesses in Resources, Development and Flexibility:** The products and markets are changing and new competitors appear all the time. If a company wants to remain in the network, it must follow the trends, developing and creating new knowledge if needed. Many OEMs consider the ability to development as one important criterion when prioritizing suppliers. It must, however, be remembered that the company will itself carry the risk of investing in changes or development. Thus the investments should be based on careful reasoning of the company's own future vision and objectives.

6.10 SUMMARY

As has been emphasized by many companies, the development of vendors becomes one of the prime responsibilities of the corporate management of any organization. A company through this development process gains on several aspects, mainly to be able to do business with competitive advantages. In this context, the networking of vendors, under different tiers, is the key action-based programme an organization will definitely opt for. There are several advantages of this approach. However, the risks involved also should not be undermined. A set of preventive measures is what is required to make vendor networking an improved way of doing business.

6.11 SELF ASSESSMENT QUESTIONS

1) Why has management of supplier network become a contemporary and critical issue? Explain with reference to the present industrial situations.

2) Draw the supply chain network indicating different kinds of flows and decision variables. What is the basic objective of such a network?

3) What are the issues critical for supplier development? Discuss each.

4) How is the performance of purchasing function dependent on supplier development? Illustrate with suitable cases and examples.

5) List the problems and risks in supplier networking. What are the preventive measures that may be suggested in this context?

6.12 REFERENCES AND SUGGESTED FURTHER READINGS

Axelsson, B. and Easton, G. (1992), *Industrial Networks-A New View of Reality*, Routledge, London.

Ford, D. (1990), *Understanding Business Markets: Interaction, Relationships and Networks*, Academic Press, London.

Hahn, C. K., Watts, C. A. and Kim, J. S. (1990), The Supplier Development Program: A conceptual Model, *Int. J. Marketing Management*, 26(2), 2-7.

Nishiguchi, T. (1994), *Strategic Industrial Sourcing*, Oxford University Press, Oxford.

UNIT 7 BUYERS-SELLERS RELATIONSHIP

Objectives

After reading this unit, you would be able to:

- describe the obligations of the purchasing manager to the company;
- discuss supplier relations with purchasing manager;
- describe the policies & important issues for relationships;
- discuss improvement aspects in relationship of buyer & supplier; and
- discuss negotiation and its rules & guidelines.

Structure

7.1 INTRODUCTION

Purchasing decisions remain largely a matter of personal judgment and it is necessarily carried on, to a great extent, through personal contacts and relationships. The purchasing manager is the custodian of company funds, responsible for their conservation and wise expenditure. He or she also is a custodian of the company's reputation for courtesy and fair dealing. The ultimate act of selecting a vendor and awarding the order is essentially a matter of patronage. For all these reasons, a high ethical standard of conduct is essential. The purchasing manager not only must act ethically but should be above the suspicion of unethical behavior. A code of conduct in this context may be a prerequisite and should be formulated. A few principles that are required to be followed by the purchasing function are as follows:

i) To consider, first, the interests of his company in all transactions and to carry out and believe in its established policies.

ii) To be receptive to competent counsel from his colleagues and to be guided by such counsel without impairing the dignity and responsibility to his office.

iii) To buy without prejudice, seeking to obtain the maximum ultimate value against each rupee of expenditure.

iv) To subscribe to and work for honesty and truth in buying and selling and to denounce all forms and manifestations of commercial bribery.

v) To accord a prompt and courteous reception, so far as conditions will permit, to all who call on a legitimate business mission.

vi) To respect his obligations and to require that obligations to him and to his concern be respected, consistent with good business practice.

vii) To cooperate with all organizations and individuals engaged in activities designed to enhance the development and standing of purchasing.

In fact, establishing a long-standing relationship with the supplier base becomes the ultimate objective of any purchasing function.

7.2 OBLIGATIONS TO THE COMPANY

The purchasing manager's obligations to his or her own company essentially consist of the responsibility for doing a complete and conscientious job in the function to which he or she has been assigned. The code wisely goes beyond this, however, in emphasizing the obligation to buy without prejudice. That implies the obligation to maintain an open mind on purchasing matters. Prejudice is usually interpreted as discrimination against particular suppliers, their representatives, or their product, usually on personal or irrelevant grounds. Basically, however, prejudice concerns an attitude of mind on the purchasing manager's part that has implications far beyond this relatively simple and elementary example. Prejudice is not altogether a negative concept. A good part of all sales effort consists of the attempt to prejudice a buyer in favor of a product or supplier. There is nothing remotely unethical about this. Often it succeeds only too well. There are probably more orders placed because of the inertia that comes from habit, reinforced by relatively trouble-free experience with an established source of supply, than are withheld because of annoyance with a salesperson's mannerisms or dislike for his or her taste in shoes.

The purchasing manager has an ethical responsibility to the company not to be put under special obligation to any supplier by the acceptance of excessive entertainment or by permitting sales representatives consistently to buy his or her lunches, even though this may be done in the spirit of ordinary business courtesy. Such relationships should be kept on a thoroughly equitable basis. For this reason, progressive companies provide their purchasing executives and buyers with expense accounts. A few important aspects in this regard are as follows:

7.2.1 Ethical Obligations

The code of conduct as mentioned is necessarily of a general and practical nature. It is certainly true in purchasing that courtesy and fair dealing beget confidence and cooperation on the part of the supplier, assets that frequently spell the difference between a merely adequate purchasing performance and a major contribution to operating efficiency and sound profits. Without these, ordinary purchasing problems can readily become serious supply emergencies, particularly in times of economic change or stress. There are opportunists and "sharpshooters" in purchasing as in every other field, but they are rarely successful over any extended period of time. A growing company that expects to be in business a year or ten years hence will do well to insist upon and to support high ethical standards in its procurement policies and practices.

7.2.2 The Problem of Gifts

It is a fairly common practice for a company to distribute some sort of gift to its customers during festival seasons. It is natural for sales representatives to direct some of these gifts to the purchasing department. In the great majority of cases, such gifts are relatively inexpensive and represent a genuine expression of appreciation and goodwill.

Many purchasing departments, however, have established a definite policy against the acceptance of such favours: First, because of the possible suggestion of commercial bribery; and second, because the cost of such gifts is a "sales expense" that eventually must be reflected in the price of the goods sold and purchased. Some weeks before the holiday season, suppliers are notified of this policy by letter. Any gifts received contrary to the policy are returned with an explanation or donated to a charity. Items of small value, usually of an advertising nature, may be exceptions to such a rule. But there is danger in the haphazard interpretation that "two cigars are acceptable, but a box of cigars must be returned."

7.2.3 The Effects of Example

The head of the purchasing function is usually concerned with prestige and efficiency in the buying operation, and will avoids placing him or her under any obligation to a supplier, as a matter of ordinary business sense. Buyers can be similarly motivated if they are convinced that the company policy is firm and is enforced and observed at every level of the company, starting at the top. Various forms of commercial bribery have taken place in many company departments, even in top management-more than most people realize. That is why the head of the department must not only establish a strong policy but set a good example.

Activity 1

Ethical conduct in purchasing depends, to a large extent, on the local culture to which the purchasing agents and suppliers belong. Get the information related to this aspect in India.

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7.3 SUPPLIER RELATIONS

All department heads, but particularly purchasing managers, have an ethical responsibility to see that their companies enjoy a reputation for scrupulously fair dealing. As the point of contact in dealing with suppliers, they have a special responsibility in this respect. Their actions and conduct are critically judged, and this judgment is quickly and widely disseminated among salespeople at large. Whether or not the criticism is justified, purchasing managers cannot afford to ignore it.

It should be clear that purchasing managers are under no moral obligation to see every salesperson. Sales interviews are but one of the many activities that occupy them. This does not contradict the policy of receptiveness and openness. Some matters are not appropriate to the company's needs; others are not timely at the moment the salesperson chooses to call. Some salespersons are inconsiderate in making frequent calls when they have nothing new to contribute. Purchasing managers and not sales representatives are the proper judges of when calls become too frequent. But this does not relieve buyers of the obligation of courtesy, a prompt acknowledgment of the call and a reason for not granting an interview. Every salesperson should be seen on the first call and be given an opportunity to tell his or her story; subsequent policy will depend on the particular circumstances. There is no justification for keeping any caller waiting for a protracted period if the interview is to be denied. And in any event, waiting time should be kept at a minimum.

Accomplishing this may be primarily a matter of organizing the reception procedure. Callers should be announced to the buyer on arrival. If there is an immediate answer, it can be given at that time. If there is to be any appreciable delay before the interview can be granted, for any reason, the sales representative should be apprised of the approximate waiting time that will be necessary.

Similar courtesy should prompt the purchasing manager to inform unsuccessful bidders when a proposition has been closed, as well as to inform the one who receives the order. Small companies, particularly, cannot afford to have a large number of proposals outstanding. This would overtax their capacity should all bids be successful. They should therefore be relieved of these tentative commitments of capacity promptly. Furthermore, if the notification indicates in what respect the proposal fell short of the buyer's requirements, it will help the vendor in future negotiations and may lead to the development of a useful source of supply for the buyer. At the same time, it will temper the disappointment of an unsuccessful bidder to know that there was a real reason for the adverse decision.

When a sample is accepted for test, it entails an obligation on the buyer's part to make a fair trial, and it is a courteous gesture to inform the vendor of the outcome of that test, at least in general terms. Some buyers find it easy to terminate an interview by accepting a sample, even if they have no serious intention of giving it a trial. Such practice verges on misrepresentation and in the long run undermine the confidence that is essential to sound business relationships. It is avoided in many companies by a policy requiring that all sample lots for trial be bought and paid for by the buyer's company. This procedure works both ways: it incurs no obligation to the vendor, express or implied, beyond the transaction itself, and it gives the company a definite interest in completing the trial and making a fair evaluation of the product or material thus acquired.

Well-considered policies of this nature build confidence and respect and strengthen the personal relationships between the buyer and the vendor. Relations with supplier are affected by a number of factors, which are briefly discussed below.

7.3.1 Obligations to Suppliers

If business is to be awarded on the basis of bids, the buyer should insist on receiving firm bids within a stated time. If the buyer permits or encourages revisions, particularly at the last moment, the way is opened for sharp dealing on the part of vendors, and the buyer is not free from suspicion of the same fault on his or her own side. *If revisions are to be permitted*, the same opportunity should be frankly offered to all bidders, and, if the specifications are changed because of an alternative product offered by one of the bidders, all should be invited to bid on the new specification.

The purchasing manager is *not responsible for a vendor's error in calculating a bid*. But, if one of the proposals seems excessively low, indicating that an error may be responsible for the discrepancy, it is good practice to ask for a recalculation. If it happens that some item has been omitted from the estimate or that a mathematical error has been made, the purchasing manager is not in the position of taking advantage of such an inadvertent slip to the detriment of the seller. On the other hand, it frequently happens that such a recalculation results in an even lower bid, although this possibility may have been far from the buyer's mind. Naturally, if the bid is accompanied by a detailed breakdown of costs and the error is patent, it would be unethical to hold the vendor to such a proposal, which obviously does not represent the vendor's real intention.

Once an order or contract has been placed on the basis of a legitimate bid, the buyer is not responsible for assuring the bidder a profit on the transaction. Sellers occasionally appeal for relief from a contract that turns out contrary to their expectations, but the buyer is under no obligation to surrender or modify his or her own contractual rights if the agreement has been made in good faith. The buyer has an ethical responsibility to his or her own company and to competitive bidders in cases of this sort. If an adjustment can be made, or an alternative source found, without sacrifice of the buyer's position, it may be wise to take such action on the grounds that service and satisfaction will be greater under the new arrangement. But the whole purpose of the contractual agreement is to provide for carrying out the transaction as planned, with a definite allocation of responsibility to both parties, including the risk of unforeseen developments. As a general rule, sellers respect the buyer who stands firmly on his or her rights and prefer to do business on this basis, having the corresponding assurance that the buyer will observe his or her responsibilities under the contract just as conscientiously.

7.3.2 Confidential Information

The buyer is under no ethical compulsion to answer questions other than those that relate directly to the proposal. Competitive price information is regarded as confidential and should not be disclosed under any circumstances. And, although it is generally true that full and frank discussion leads to a better mutual understanding and perhaps to a better purchase, there are circumstances in which factors other than price are also of a confidential nature.

Although trade secrets are much less a factor in industry today than they were a generation ago, there are still a number of things that a company may wish to keep strictly within themselves. All buyers are well aware that suppliers rarely know the full extent of the uses that their product serves, the buyer may need to waive the benefits of any implied warranty on the seller's part and has no basis for later expressing dissatisfaction or pressing a claim for unsuitability in his or her purchase. The seller who is not informed as to the intended use is bound only to the extent of conformance with any specifications that may be set forth in the order.

7.3.3 Sharp Practice

The term "sharp practice" is best defined by some typical illustrations of evasion and indirect misrepresentation just short of actual fraud. They belong to the old school of unscrupulous shrewdness, when buying was concerned with the immediate transaction rather than the long-range programme. These examples would have been commonplace among an older generation of buyers, and sellers in that period were habitually on their guard against such possibilities. In modern procurement and marketing, which are based on mutual confidence and integrity, such practices are frowned upon just as severely by the buyers themselves as by the sales organizations with which they deal.

It is sharp practice for a buyer to talk in terms of large quantities, encouraging the seller to expect a large volume of business and to quote on a quantity basis, when in fact the actual requirement and order are to be in relatively small volume that would not legitimately earn the quantity consideration.

It is sharp practice to call for a large number of bids merely in the hope that some supplier will make an error in his or her estimate, of which the buyer can take advantage.

It is sharp practice to invite bids from suppliers whom the buyer will not patronize in any case, using these quotations only for the purpose of playing them against the proposals of those who are really acceptable sources of supply. It costs money, time, and effort to prepare estimates and bids. Sellers are glad to undertake the expense in the hope of securing a contract, but the buyer has no right to impose these costs on a seller when the buyer has no intention of giving the seller an opportunity to get the business. .

It is sharp practice to leave copies of competitors' bids or other confidential correspondence in open view on the desk while negotiating with a seller, in the knowledge that the latter can scarcely fail to notice them.

It is sharp practice to deal only with "hungry" suppliers and to try and keep them hungry so as to force concessions. More generally stated, this applies to any abuse of purchasing power to the detriment of the seller. Although it is legitimately expected of a purchasing manager to make full use of his or her company's purchasing power, this factor should normally operate to mutual benefit, with the buyer's position strengthened by virtue of being a more desirable customer, offering greater volume, steadier flow of orders, more prompt payment, or similar considerations of value to the seller.

7.3.4 Combating Unethical Practices

The subject of business ethics is not one-sided. Purchasing managers and buyers are faced from time to time with unethical sales practices. There is sharp practice in selling, collusive bidding, restrictive conditions in specifications, artificial stimulation of demand and prejudice among shop operatives, sabotage of competitive products, padding of orders and shipments, use of unfamiliar trade terms and measurements, supposedly sample orders that are magnified into excessive quantities, obscure contract clauses buried in small type, and many others. In most cases these can be avoided by proper selection of vendors, but perhaps only after unfortunate experience has indicated the disreputable sources of supply. In dealing with some of the practices, such as collusive bidding, more direct and aggressive action is called for as a corrective measure.

What is needed to restrict such unethical practices is competent, objective buying, supported by the necessary follow-through with insistence on contract performance, acceptance testing, and the like. The purchase order or contract in itself constitutes a legally enforceable document. All supplementary agreements, specifications, and special terms should likewise be reduced to writing, using care to see that no ambiguity exists in respect to what is expected of the seller.

Confidence in a supplier is an essential of any sound purchasing department, but confidence need not be blind. It must be earned and the reputable supplier welcomes the opportunity to show that he or she is worthy of confidence.

7.4 POLICIES FOR RELATIONSHIPS

Every purchasing department has policies, whether or not they are put into writing. They are one of the administrative tools of departmental management. There are three specific advantages of establishing these policies:

i) an established policy eliminates the necessity for making a new decision every time a comparable situation arises,

ii) a written policy assures understanding and ensures that decisions and actions are consistent and in accordance with the judgment of the responsible department head, and

iii) an approved policy gives authority to the indicated course of action.

The policies may be described under the following categories.

7.4.1 Internal Relationships

The establishment of a purchasing department is in itself a policy or company management. It immediately entails a whole series of internal and interdepartmental policies relating to lines of authority, channels of procedure, and departmental relationships in general. These policies should be promptly clarified and made a matter of record, for they define the scope and responsibilities of the purchasing function in any particular organization and determine to a considerable extent the effectiveness of the purchasing operation. Neither can they be set by the purchasing manager alone, because they affect the responsibilities and actions of other departments as well.

Policies in this category include such matters as the authorizations required on requisitions to purchase, permissions for vendors' sales representatives to contact plant personnel, the final responsibility for specifications, the procedures to be followed in standardization and value analysis recommendations involving engineering changes.

To be effective, a policy must be clear and definitive, but it need not be arbitrary. Consequently, many policies set up criteria for decisions, or methods of handling situations, or conditions of action. For example, it is obviously undesirable to grant free access to plant personnel for all vendors' sales personnel, either at their own initiative or at the request of plant managers, for such a policy would negate the principles of centralized purchasing. Yet there are many situations in which such a contact is mutually desirable and is, in fact, an aid to intelligent procurement. A sensible and commonly accepted policy on this point is to require that such contacts be made through the purchasing department and that in such interviews no commitments are to be made by plant personnel as to preference for products or sources, which might weaken the position of the purchasing department in subsequent negotiations.

7.4.2 Vendor Relationships

Relationships with vendors and their representatives, too, are subjected to policy control. It is for the buyer to decide whether a particular proposal from a supplier is pertinent and timely from the viewpoint of the company's needs and whether the interview time is warranted. The purchasing department may suggest fixed calling hours, and, make provision for exceptions in the case of the out-of-town caller and special appointments. The policy guidelines may dictate that

i) price information is kept confidential for industrial purchasing,

ii) vendors are permitted to revise their bids only in case of obvious error, or in a subsequent negotiating stage if terms, quantities, or specifications are modified so as to warrant a price adjustment,

iii) if it becomes a new proposal on the buyer's part, a new request for bids may be in order,

iv) if the vendor is selected on merit, on the basis of the original proposal, and the terms are altered in negotiation, he or she will probably stand on the original choice,

v) unsuccessful bidders are required to be with the reasons for the adverse decision, if feasible.

Ordinarily, purchasing policy favours the use of the buyer's standard order form and terms in all cases. But sometimes, when Installations and special warranties are involved, the vendor's form that is specifically designed for these situations is more appropriate and obviates the need for writing in a lot of special clauses and conditions on the buyer's form. For such cases, purchasing policy can set up certain criteria for the acceptability of a seller's form. These criteria safeguard the rights of the buyer and avoid conflict with other basic company and purchasing policies. The policy may include getting approval of the contract by the company's legal department.

It may be good policy to use personal contacts on a systematic basis and to extend it with a policy of inviting vendors periodically, individually or as a group, to acquire a personal knowledge of the buyer's plant operations.

7.4.3 Policies On Supply Source

Another group of purchasing decisions that lend themselves to the guidance of a consistent and considered policy concerns the selection of supply sources. The policy of maintaining multiple or alternative sources is almost universal. But this does not answer the question of what kind of sources should be chosen.

The local supplier usually offers natural advantages of convenience, faster deliveries, and lower transportation cost. There are factors that weigh in his or her favour in any source consideration. However, the objective appraisal of supply sources may show others to be equally or more desirable, and a more distant competitor may underbid the local bidder sufficiently to offset his or her initial advantage. To foster good community relations local sources sometimes, are given business thereby helping maintain local prosperity by keeping business in the local area. These factors have enough validity and importance to make some companies go so far as to establish a small percentage cost differential that is considered acceptable in dealing with local sources, all other things being equal. Such a policy is usually permissive, rather than mandatory.

Assuming that facilities are adequate and that prices are competitive, the policy should be made known regarding preference of small or large companies as suppliers. The case for the small company as a supplier usually hinges upon the fact that an order or account of given size looms proportionately larger in the operations of a small supplier, and it is logical to expect that he or she will give it closer individual attention and service than it might receive in the larger organization, where it is of relatively minor importance. Another argument cited in favor of the small company is the rather paradoxical one that the buyer's patronage helps the small company to grow larger and hence the buyer will get greater loyalty and cooperation from the small supplier. Both arguments are probably unfair to the many efficient and conscientious large supplier companies that have attained their present stature through high standards of service.

Should an effort be made, as a matter of policy, to deal, so far as possible, directly with primary manufacturing sources rather than through distributors and other middlemen? If quantity warrants, there may be some price advantage on direct shipments. If the distribution system and price structure are such that there is no saving on direct purchases, as is often the case, there may be advantages in the distributor's services. A reputable manufacturer supports his or her products and warranties, and usually provides essential technical services in either case.

7.4.4 Reciprocal Purchasing Policy

One of the most troublesome and controversial policy questions that purchasing executives have faced is that of reciprocity. The urge to select suppliers on the basis of how much they may buy from one's company is both common and understandable. But it generally does not come from those purchasing managers who take scientific purchasing seriously. Most of the effort to promote reciprocal buying comes either from suppliers or from within the buyer's own organization, usually from top management or the sales department.

Under any form of reciprocal buying policy, purchasing becomes less selective because freedom of choice from among several suppliers is limited. It negates the critical criteria that scientific purchasing calls for in the selection of sources, and it discourages competition among other suppliers, who quickly become aware of its existence. In short, the purchasing manager may lose of negotiating and buying power.

7.5 IMPORTANT ISSUES IN RELATIONSHIPS

Let us discuss some important issues in relationships.

7.5.1 Cordial Relations between Buyers and Sellers

The buyer as well as the seller know very well that good relations are essential for the smooth running of a business. Yet there are many suppliers who frequently fail to meet the delivery schedules and fail in quality standards. The suppliers on the other hand complain about delayed payment, cancellation of orders, and increased rejection due to rigid inspection. In any organization, it is the prime responsibility of the materials manager to keep relations smooth.

The buyer and seller must recognize that they are partners in a work that requires joint responsibility, and as such, good relationships between them can go a long way in adding to the vitality of on-going professional relationships as well as in increasing the effectiveness. The underlying philosophy should be based on mutual confidence and should be one of inter-dependence. The primary objective of the relationship is to buy and sell for a profit. The supplier can assist the buyer through ideas for cost reduction, new products and, service even during a crisis. Such healthy relationships are possible only when both the parties are competent in their profession and respect the principles of human relations. For example, if the supplier lacks the know-how and facilities to meet the specifications sought by the buyer, he will be of little help. Similarly, if the buyer lacks techniques of negotiating with the suppliers, he can never hope to develop a meaningful relationship with the supplier. The buyer should consider a good vendor as an intangible asset of his organization.

7.5.2 Control In Practicing Reciprocity

Reciprocity is the practice of selecting one's own customers as suppliers. In fact, under reciprocity, the materials manager may even accept slightly higher prices from a supplier because he is also a customer. Sometimes this practice may result in strained relations between other suppliers and the buyer. Whereas reciprocal buying is advantageous in boosting the sales and fosters goodwill with the suppliers in question, it is not a desirable practice as in many cases such suppliers are very small in number. This is especially so in the case of companies which have only one product to offer when many of the suppliers will find no use for the product.

7.5.3 Backdoor Selling

Suppliers' salesmen form an excellent source to developing healthy and effective relations. Many companies provide information to the salesmen as the names and locations of the buyers responsible for different commodity classifications, a physical locations of purchase departments, norms of the company with regard to suppliers' salesmen etc. This may imply that they need to have dealings only with the concerned buyer. On no occasion, except with the buyer's explicit approval, should they meet the operating personnel. Several arguments can be put forward to justify this. Firstly, it is the buyer's responsibility to meet the seller's salesmen for which he gets paid. Secondly, salesmen may unnecessarily waste the time of operating personnel in discussing problems which are better sorted out by the buyer. Further, the user should not be directly approached by the vendor for ethical considerations.

7.6 IMPROVEMENT IN RELATIONSHIPS

Buyers should make it a point to look upon their relationship with suppliers as one of inter-dependence. It is essential that buyers should understand the needs of suppliers. Suppliers expect fair and honest dealings, ethical practices and a minimum amount of rush orders. During negotiations they prefer to deal with buyers who have sufficient authority, and who are reasonable and well informed. The materials manager must ensure that personal contacts are encouraged. In this context, the buyer should periodically visit the suppliers' plant and assess the suppliers' strengths and weaknesses.

Many buyers have found it useful to organize meetings of their suppliers periodically, to develop personal contacts and to acknowledge inter-dependence. Some buyers believe in organizing 'informal meetings' with major suppliers to explore possibilities for cost-reduction. The following steps may ensure that buyer-seller relationships are kept at a healthy level:

i) Inform the vendor of the major purchase policies.

ii) Make it a point to give the salesmen a courteous reception when they visit the plant and interview them as per pre-arranged schedule.

iii) Give adequate notice to the vendors so that they can be ready with quotations. Recognise any extra service rendered by salesmen through a letter of appreciation.

iv) Be ready with "home work" so that negotiations can be businesslike and to the point. This requires the obtaining of complete quotations, tabulations, and vendor rating information. When a buyer is armed with such information, his negotiations with the supplier are purposive and the supplier also saves his time and effort.

v) Keep rush orders at a minimum and inform the unsuccessful bidders as to why they have not received the orders.

vi) Allow permissible tolerances in inspection and forward inspection reports to the vendors with suggestions so that they could improve.

vii) Ensure the removal of rejected materials from the buyer's premises promptly.

viii) Do not cancel orders with suppliers at the last minute. Give sufficient notice to the supplier for the cancellation of all order.

ix) Clear the outstanding bill of the suppliers as expeditiously as possible.

Many other factors, such as fair dealing, living up to the agreements in both letter and spirit, assisting suppliers in development, proper appreciation of each other's difficulties and mutual confidence can help in moulding cordial buyer-seller relationship. It is necessary that the buyer should have an adequate and competent staff who could assist him in scheduling interviews with the suppliers, preparing the necessary groundwork, soliciting and refining the opinions of the suppliers for corrective measures and so on.

Attempts must also be made by the materials manager to evaluate his department's relations with suppliers from time to time. He should compare, over a time period, a number of factors, such as the number of visits made to suppliers' plants, number of meetings held with the suppliers to sort out mutual difficulties and complaints regarding gifts, backdoor selling.

7.6.1 Importance of Public Relations

Good public relations and sound ethical principles contribute towards better buyer-seller relationship. Public relation is very important for the image of an organisation and significantly contributes to the buyer/seller relationships. The materials manager is in a position to contribute significantly to the public relations efforts of the company. It is quite possible that the materials manager in discharging his duties may have good relations with some and not-so-good relations with others. The underlying philosophy in any public relations effort is the ability of the members of the organisation to put themselves in the position of the persons with whom they deal and view the situation from their angle as well.

Public relations may be looked upon as an effort to develop a favourable climate and attitude towards the company, or to create a good image for the company. It can also be defined as an effort through which the company hopes to ensure the understanding and goodwill of its customers, employees, suppliers, as well as that of the public in general. By this definition, it follows that this effort consists of two parts. The first part concerns internal relations, and the second pertains to external relations.

i) Internal Public Relations

The materials management function is required to work with other functional departments of a company. Naturally, a good relation and rapport with other departments ensure that materials management can function very effectively. This rapport can be achieved through the realisation of the interdependent nature of the relationships, without tending to overemphasize one function in relation to others.

There are very simple yet effective ways in which such a relationship between materials management and other departments can be established. Apart from formal communication channels, every organisation has its informal channels. These channels are of great help in getting to know the other departments' problems with materials management so that remedial measures can be taken. There are several reports which are of interest to user departments. For example, a report on substitute materials, transport bottlenecks, delay in supply position, and incoming materials quality, may be of great assistance to the production department. Similarly, reports on price trends may be of interest to the finance department. Such formal reports in combination with informal channels can considerably foster good relations within the company.

ii) External Public Relations

Normally, the materials manager is the first point of contact between his organisation and the suppliers. He must recognise the value of time, show understanding and appreciation of the services, information given and suggestions made by the representatives of the suppliers. It is likely that with some representatives no business is possible for a long time. Yet a diplomatic knack of tackling them will keep future business open to both the parties.

During the course of his job, the materials manager writes to many outside agencies. This could act as an effective public relations tool. Prompt replies to suggestions, quick intimation about price changes, courtesy in written communication and telephonic conversation, prompt reception to salesmen, and courteous interviews, may go a long way in building up the image of the company, in general, and the purchase department in particular.

Quite a number of organizations have found it desirable to periodically feed the suppliers about the quality and delivery performance and furnish inspection reports, thus pointing out the areas where improvements are desired. Such initiatives really strengthen the rapport between the suppliers and the buyer.

7.6.2 Training In Relationship Skills Development

In the backdrop of fast changing technology and an ever growing economy, the function of the materials manager is becoming quite challenging. A seller's market as well as the increasing impact of government policies together make the challenge. Furthermore, top management is increasingly expecting the materials department to play a vital role in the company's cost reduction aspects. Therefore, additional skills have to be imparted to prepare an executive to react effectively to changes. An exposure of the purchase manager to sensitivity training and workshops can prepare him to function effectively within the organisation as well as with outside agencies and help him to project a favourable image. Role playing and case studies are some of the well known training techniques which will prepare the materials manager to handle public relations functions effectively.

One of the hallmarks of a professional person is that his devotion to excellence in his chosen field outweighs the selfish desire for personal gains. In this context, agencies like the National Association of Materials Management, the Materials Management Officers' Association of India and the Indian Society for Materials Management can play a significant role in promoting the image of the materials management profession. The advantages of membership in such agencies are not far to seek. The members get an opportunity to meet and exchange ideas. Such agencies do bring out periodicals and the members can effectively use this media to air their views and contribute professional articles. The suggestions of these agencies are considered by the government while formulating import policies or in allocating critical raw materials. These professional agencies can aid the individual materials managers in improving buyer-seller relationship as well as the ethical standards of the profession.

Activity 2

Compare and contrast in respect to (i) buyer-seller interrelationship, and (ii) types of contract management between military hardware and civilian products in India. Make a library/internet search on contract management in military organizatins.

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7.7 NEGOTIATION IN PURCHASING

Negotiation is one of the more important and interesting aspects of the purchasing cycle. It can also be one of the most stressful parts of arriving at a purchasing agreement. Negotiation is complex and costly, and is used primarily for high volume purchases and for new items where costs are unknown. High value purchases do not automatically dictate the use of negotiation. The competitive bidding process is the preferred method of purchasing, because competition is more likely to determine the right price than are most skilled negotiators. When competitive bidding is not feasible, negotiation becomes the appropriate method of purchasing.

7.8 DETAILS OF NEGOTIATION

Webster's defines negotiation as "conferring, discussing, or bargaining to reach agreement in business transactions." For the purchasing agent, negotiation must be used in its broadest sense, as a decision-making process regarding a purchase order. In this context, negotiation is a process of planning, reviewing, and analyzing all data used by the seller and the buyer to reach an acceptable agreement for the purchase order, which includes all aspects of the business transaction, not just price. Thus, *Negotiation* may be defined as "the process of working out a procurement and sales program together, to the point of reaching a mutually satisfactory agreement."

In practice, the term is generally applied in industrial purchasing to the more complex situations involving buyers and sellers, in which both make a number of proposals and counterproposals before an agreement is reached.

7.8.1 Elements of Negotiation

Negotiation depends on the use of communication skills and involves the psychology of persuasion. The purchasing agent must know that negotiation in itself is a useful tool of human behavior, for negotiation is conducted between two individuals, and as such, can be mastered by study and practice.

The purchasing agent should enter negotiation with a positive attitude toward achieving the objective, as well as having decided upon the maximum extent of his potential concessions. Nothing contributes more toward successful negotiation than advanced planning of strategy and setting the objective.

7.8.2 Objectives of Negotiation

The main objectives of negotiation are as follows:

i) to obtain a fair and reasonable price for the quantity requested,

ii) to receive assurances that the supplier will perform on time,

iii) to exert some control over the manner in which the contract is performed,

iv) to persuade the supplier to give the buyer's firm maximum cooperation, and

v) to develop a sound and continuous mutually beneficial relationship with competent suppliers.

Contracts often contain clauses pertaining to changes in the original agreement, which are usually made by negotiation. A typical contract contains the following information:

i) Price (escalation clauses, redetermination clauses, allowable costs in cost-plus contracts, etc.).

ii) Quantity, quality, delivery schedule, and mode of transportation.

iii) Terms or other conditions that may alter the performance of the original contract.

7.8.3 The Negotiation Process

Prior to any negotiation session, the purchasing agent negotiator must evaluate all relevant information and assess his or her own strengths and weaknesses as well as those of the supplier. From this assessment, the purchasing negotiator develops the tactics and strategy for negotiation. This plus the negotiating skills are the controlling factors that can be influenced by the level of preparedness for any and all contingencies.

The first step in planning for negotiation is to establish the objectives. In developing these objectives, actual numerical ranges are established for quality acceptance, actual dates of delivery, and actual monetary value for applicable elements of cost. The major elements of cost traditionally negotiated include quality of material, quantity of material, quantity of labour, labour wages, price of material, factory overhead, and other costs entering the price factor. It must also be noted that the purchasing agent should never enter into negotiations unless the supplier's negotiator has the authority to agree to any or all of the points in the negotiation.

The following issues become highly relevant in the negotiation process:

i) **Supplier's Bargaining Strengths**

The seller's bargaining strength usually depends on the following three factors:

i) the seller's desire for the contract,

ii) the seller's certainty of getting the contract, and

iii) the time available for negotiation

The seller's desire for the contract: The purchasing agent should encounter no difficulty in determining the eagerness of the seller for the contract by noting the frequency of the sales representative's calls about the goods in question and by knowing general market conditions. These are positive indicators of the seller's interest in the contract. The seller's annual financial report, as well as the backlog of orders, volume of operation, and the trends of the industry are valuable information.

The less a seller needs or wants a contract, the stronger is his bargaining position. The presence of an industry boom places the seller in a strong bargaining position. The reverse is true in a general recession or when the seller has excess unused production capacity.

The seller's certainty of getting the contract: If a seller learns that his prices are lower than his competitors' or that he is the preferred source or the sole source, the seller will conclude that the chance of obtaining the contract is almost 100 percent.

Under these circumstances the seller can become most difficult to deal with during any negotiation. In extreme situations, the seller may be unwilling to make any concessions.

When trapped by such circumstances, the purchasing agent may threaten delay and search for an alternate source. Such approach is likely to be ineffective unless the supplier knows that other sources are available and interested in the contract. Another option, when no payments are involved, is for the purchasing agent to threaten to have the item manufactured in the plant. When made realistically and the seller believes that the buyer's plant has the technical know-how and capacity to make the item, this threat gets consideration.

A firm's negotiating position is always strengthened when the firm has a policy that states that only the purchasing agent has the authority to discuss pricing, timing, and other contractual conditions with the seller. Most pre-negotiation leaks give the seller a feeling of self-confidence about getting the contract. Such leaks are often from the technical or production staff, and because they are often undetected by general management, they can be a continuing source of profit loss.

The time available for negotiation: Short lead time drastically reduces the purchasing agent's bargaining strength. Once the seller learns of the short lead time, he merely "drags his feet" and negotiation terms become favourable to him.

ii) Purchasing Agent's Bargaining Strengths

The purchasing agent's bargaining strength also depends on the following three factors:

i) the extent of competition among the potential sellers,

ii) the adequacy of cost and price analysis, and

iii) the thoroughness of preparation by the purchasing agent.

The extent of competition among competitors: The greater the number of potential suppliers, the greater is the purchasing agent's bargaining strength. The general economic climate, among other factors, has a substantial bearing as to the extent to which supplier wants to compete. The backlog of orders, shop load, and inventory position, are the other factors that have a stray bearing on the ever-changing competitive climate. If necessary, the purchasing agent may increase competition by developing new sources of supply, buying supplier companies, providing tools, money, and management to competent but temporarily weak suppliers, or by making the items in-house rather than buying.

The adequacy of cost and price analysis: A comprehensive knowledge of the principles of cost and price analysis is one of the basic responsibilities of an effective purchasing agent, and more so for the- purchasing negotiator. The greater the amount of information available to the purchasing agent concerning the various costs of the supplier, the greater is his bargaining strength.

The thoroughness of the purchasing agent's preparation: The more knowledge the negotiator acquires about the theory and practice of negotiation, the supplier's bargaii1ing position, and the items being purchased, the stronger his bargaining position becomes. A purchasing negotiator without a thorough knowledge of the item being negotiated (how it is used, what items can be substituted for it, its alternate method of production, and his company's future requirements for the product, etc.) is greatly handicapped in negotiation. The purchasing agent is similarly handicapped if he has not studied, analyzed, and evaluated every detail of the supplier's proposal. Whenever feasible, before requesting quotations or entering negotiations, the purchasing agent should estimate the price and value levels of the product to be contracted for.

Knowledge of current economic conditions as well as trends in the market for the product in question are also essential to preparation.

iii) Negotiation Techniques

A competent negotiator determines before, or very early in, the session which of the *concessions* he is prepared to make are of the greatest importance to the supplier. By holding off in these areas while making minor concessions in other areas, the purchasing agent retains assurance of making substantial gains later in the session. Once the purchasing agent makes the concessions important to his adversary, he loses his bargaining strength.

The buyer should strive *never to lose the initiative* that he automatically obtains when he receives the supplier's proposal. The competent buyer always "carries the game" to the supplier. He should keep the supplier on the defensive by making him justify his position.

The *wise use of questions* is a very important technique in negotiation. By properly timing and phrasing the question, the negotiator can control the progress and trend of the negotiation. The *technique of answering* questions is just as important as the technique of asking them. The competent negotiator knows when to answer, when not to answer, when to answer clearly, and when to answer vaguely. Not all questions require an answer.

The *correct answer* in negotiation is not governed by the same rules governing answers in the classroom. In case of negotiation questions, the correct answer is the answer that helps promote short-term tactics and long-term strategy.

Another important characteristic of a competent negotiator is being a *good listener*. By listening the buyer can learn the basic need of the supplier. Suppliers may talk themselves into concessions the buyer could not otherwise gain. Listen carefully to the choice of words, phrases, and tone of voice; at the same time observe any gestures or "body language" used. They can be revealing.

There is also the *human side* to negotiations. The buyer may know the supplier's representative; if not he should strive to learn as much as possible about the personal habits of that representative. When tempers start to get out of hand, as they occasionally do, the experienced negotiator quickly diverts attention from the "stressful" situation at hand. A joke or a tea break can be an effective method for easing the tension. This type of diversion is usually more easily accomplished when each participant knows what situations are most irritating to the other.

In most purchasing negotiations, interdependence is the backbone of bargaining relationships. Neither the buyer nor the seller can achieve any goal without taking the goal of the other into consideration. The end product of negotiation is an exchange of concessions that result in a contract advantageous to both parties. While both buyer and seller benefit from a well-negotiated contract results are seldom divided 50:50. In most cases a 60:40 contract results because one negotiator is more skillful.

The process and techniques of negotiated purchasing deserve special attention for two basic reasons. First, the whole concept of negotiation is widely misunderstood, and in many cases suspect, even by persons engaged in purchasing. Second, technological change has made industrial procurement increasingly complex, particularly in defense-related industries. Simple rule-of-thumb approaches to buying one-of-a-kind machines or systems, for example, are no longer adequate. Nor are they any longer satisfactory in the purchase of less complicated items like raw materials and maintenance supplies. The trend toward long-term purchase agreements on these commodities has placed special emphasis on many aspects of the transaction that are open to negotiation. Responsibility for holding inventory, timing of deliveries, methods of transportation, inspection, and prices are only a few of the factors that must be agreed upon before a purchase is complete.

7.9 COMPETITIVE BIDDING AND NEGOTIATION

When competitive bidding is used in industrial purchasing it usually indicates that there is a market for the item and that some prices level has been established. The product to be bought is an accepted standard and its specifications are relatively simple and clearly spelled out.

Negotiation, on the other hand, calls for face-to-face discussion by buyers and sellers to hammer out details of a contract too critical to be covered by an exchange of paperwork. The product under consideration may be one-of-a-kind of special design or competition. There are rarely competitive markets for such items, and certainly no established prices. Negotiation is definitely called for when buyer and seller have different estimates of what it costs to make, deliver, and service a product. Negotiation invariably involves discussions on a range of elements that go beyond price, such as warranties, technical assistance and service, methods of shipment and packaging, and payment terms. Even contracts for standard items requiring large expenditures over a year or more should be negotiated on the same basis.

Negotiation is generally used in the following situations:

i) When the purchase involves equipment of a unique or complicated nature that has not been purchased before and for which there is little cost information. A conveyor line for a new, automated food-processing plant is an example. Details of the construction, performance, and cost of such an installation require involved technical discussions before a purchase was actually made.

ii) When prices of an item are fixed, by custom, "fair-trade" laws, or actual collusion among suppliers. If there are many suppliers in the field, good negotiating tactics are generally successful in winning concessions from one producer who is anxious to get the business.

iii) When there are few suppliers or only one in the field, but the product in question can be made in the buyer's own plant or bought from abroad or a substitute for it is readily available.

iv) When a number of suppliers have bid on an item, but none of the quotations is completely satisfactory. None may meet the buyer's requirements as to price, terms, delivery, or specifications. In this situation, the buyer must be sure, before he or she attempts to negotiate, that all bids are unsatisfactory in terms of the requirements that he or she first placed before the suppliers. It is highly unethical to lead a supplier into committing himself or herself in a quotation merely to put him or her into a disadvantageous bargaining position. Responsible buyers will notify suppliers in advance that bids may be subject to negotiation.

v) When an existing contract is being changed and the amount of money involved is substantial enough to warrant discussion. Major price changes on high-volume items, for example, are subject to negotiation.

7.10 NEGOTIATING GUIDELINES AND RULES

Negotiation is often a highly technical matter, but it is always a very human matter as well. Because the essential element in a negotiation is bargaining between individuals, the process involves personalities, human motives, people's strength and weakness, and a great deal of psychology. The following general rules are worth mentioning in this context:

i) *Try to have the negotiation carried on your home ground, according to your own arrangements*. There is a psychological advantage to having the other party come to the discussion. It implies that you arc in control and have already won one concession. Provide a dignified, comfortable, well-lighted meeting place, free of distractions. Put the leader of your own negotiating team at the head of the table, and try to keep the members of the other team separated.

ii) *Let the supplier do most of the talking.* At least, in the beginning. Let the supplier give the reasons for his or her demand first. If you use the proper restraint, he or she may talk himself or herself into making concessions that were never intended.

iii) *When your time comes to talk, don't fumble over facts and figures*. Never send out for vital information in the middle of a discussion. Lack of information or lack of confidence puts you at a strong psychological disadvantage.

iv) *Try to avoid emotional reactions to the supplier's arguments or an emotional approach in presenting your own.* Otherwise, you'll obscure the real purposes of the negotiation and possibly endanger your own position. A person who lets pride or anger govern his or her relations with others usually ends up by giving away more than he or she intended.

v) *If the supplier has to retreat on a point, let it be done gracefully.* If you spot something wrong in a cost estimate, for example, don't accuse the other side of trickery or ineptitude. Suggest that a revision is in order.

vi) *Avoid premature showdowns.* You have to come to some sort of a showdown ultimately—that's the reason for the negotiation. But, if you force a supplier into a position in which he or she feels compelled to say, "Here are my terms, take them or leave them," that may end the discussion there. After that kind of an ultimatum it would be difficult for the supplier to give further concessions. So, before you make your final concession, be absolutely sure that it is absolutely final.

vii) *Satisfy the emotional needs of the people with whom you are negotiating.* Most suppliers enjoy selling and persuading, but they are somewhat insecure. Give suppliers a chance to persuade rather than trying to head them off brusquely, and they will be better disposed to make concessions to get your business. And give them the impression that, despite your bargaining with them, you respect their position and regard them as members of your corporate team.

Attributes of the person negotiating a contract play a crucial role for successful negotiation. In this context, one must be familiar with the attributes of good negotiation. The attributes of good negotiators may be as follows:

i) They must be clear, rapid thinkers. The give and take of a complex negotiation requires a person bale to think quickly.

ii) They must express themselves well and easily. In negotiation what you know may not be as important as what you convey to others. The ability to communicate effectively is an absolute must. Ease of expression does not mean glibness. It comes from a knowledge of the business at hand.

iii) They must possess the ability to analyze. They must be able to analyze the statements of others and identify those who favor their position, those who oppose it, and those who favor another solution.

iv) They must be impersonal. In the heat of a hard-fought negotiation, it is sometimes difficult to remain calm. But a negotiator must always approach a problem from the basis of the company objective rather than from personal inclinations.

v) They must be patient. Sometimes letting the other persons talk themselves out or explain their positions helps resolve issues without argument.

vi) They must be able to consider other person's ideas objectively. They should be able to place themselves in their opponents' frames of reference, so they can better evaluate those positions.

vii) They must be tactful, have poise and self-restraint, like people, and have a good knowledge of human nature.

viii) They must possess a sense of humor. You can't win every point in a negotiation. An ability to make concessions and to continue to display good humor will pay dividends in good will, which will help in resolving the remaining issues.

7.11 SUMMARY

Negotiation is the basic process by which competition is furthered in industrial buying and selling. It is the special responsibility of the purchasing agent to negotiate the best possible deal to achieve company objectives, just as it is the special responsibility of sales representatives to negotiate for their companies's objectives. In order to have best-possible advantage and to create a good image of the buyer's company, it is essential that sound purchasing policies based on ethical standards be followed. This will ensure a long-standing relationships between the buyer and the seller. A set of general rules may be developed for this purpose by a company, and the purchasing agent of the company must have adequate skills and attributes that help him or her establish as a successful negotiator.

7.12 SELF ASSESSMENT QUESTIONS

1) Describe a few situations in which negotiation is considered the appropriate method of purchasing.

2) Explain the difference between purchase by competitive bidding and purchase by negotiation.

3) Mention the basic principles and techniques to be followed in purchase by negotiation.

4) What are the factors that influence the buyer-seller relationship? Discuss them in brief.

5) Discuss the important policies that a company is required to use to foster good buyer-seller relationships.

6) 'Sound ethical principles contribute toward better buyer-seller relationships'. Comment.

7) What precautions a company should take to maintain sound ethical purchasing norms and practices?

7.13 REFERENCES AND SUGGESTED FURTHER READINGS

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