

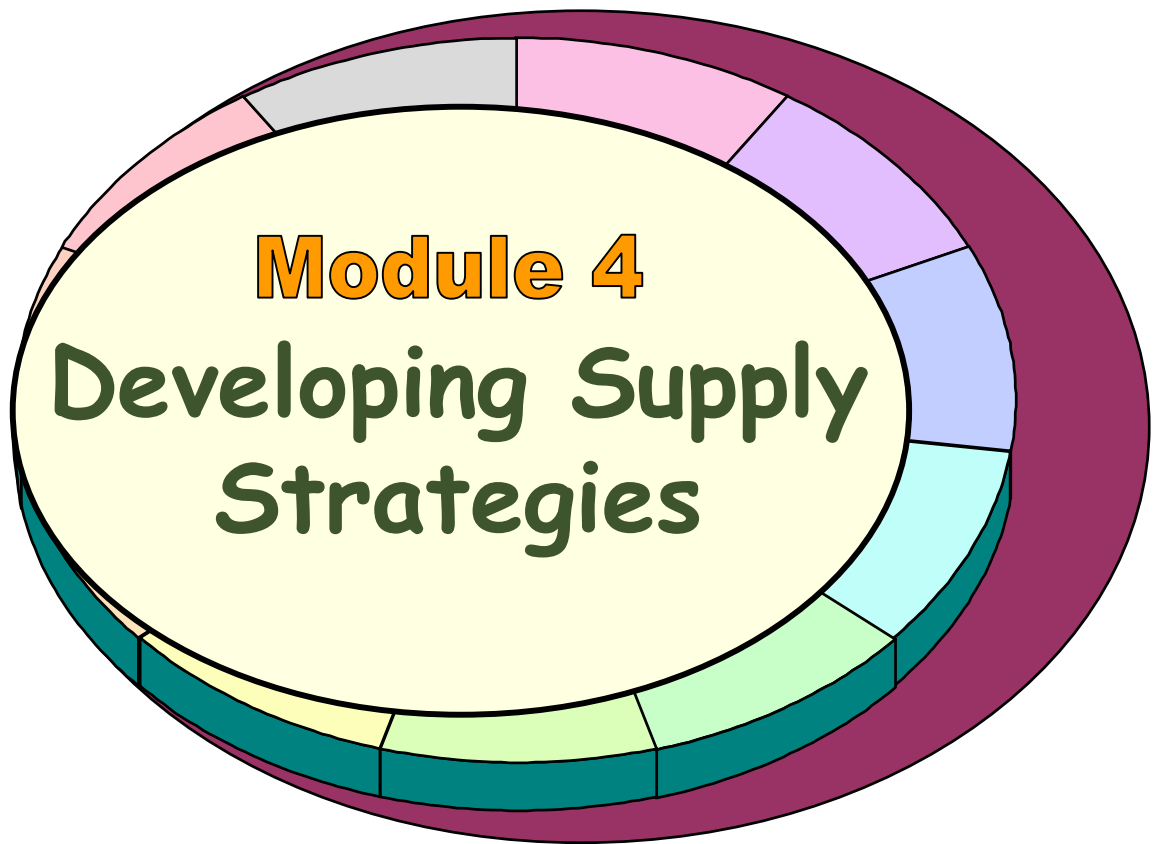


**International Trade Centre**

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**Sample Pages**

**International Purchasing & Supply Management  
Modular Learning System**



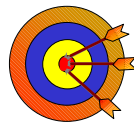
**Coursebook**

"Buying into competitiveness"

<b>Unit 1</b> Introduction	<b>Unit 2</b> Framework for Supply Strategy	<b>Unit 3</b> Relation- ships & Contracts	<b>Unit 4</b> Routine Items	<b>Unit 5</b> Leverage Items	<b>Unit 6</b> Bottleneck Items	<b>Unit 7</b> Critical Items	<b>Unit 8</b> Commodi- ties
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## Unit 2

# A Framework for Supply Strategy



### Learning Objectives

By the end of this Unit, you should be able to:

- ◆ Describe how supply strategy serves your supply objectives and, through these, to achieve your firm's corporate strategy.
- ◆ Identify the four quadrants of the Supply Positioning Model and describe their main features and implications for supply strategy.
- ◆ Describe when it is generally better to go for one or for more markets as sources of supply.

2.1 Linking supply & corporate strategy

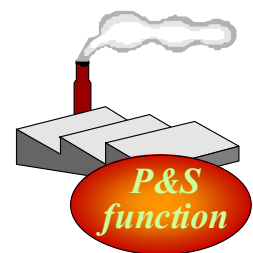
2.2 The Supply Positioning Model

2.3 Single or multiple market segments

## 2.1 Linking Supply Strategy to Corporate Strategy

Having reviewed what we mean by supply strategy, in this Unit we will look at the following three issues:

- ◆ How supply strategy is linked to corporate strategy and policy.
- ◆ How the Supply Positioning Model can help you in developing your supply strategy.
- ◆ How to decide on whether to use single or multiple supply market segments.



All strategies within your enterprise, including the supply strategy, should be aligned with your corporate strategy. Corporate strategy involves looking at issues such as:

- ◆ Which products or services your company wishes to sell, and to which markets.
- ◆ Which are the conditions under which it will offer its products and services.

- ◆ Which are the ways it intends to enter and develop those product-markets.
- ◆ How the company will be organised and operated in order to achieve the levels of cost-effectiveness it need to be competitive in its area of business.

The outcome of corporate strategy is a set of priorities relating to implementing its product-lines, the projects it intends to develop and the ways in which its functions and processes will operate<sup>1</sup>.

Based on all of these considerations, the purchasing & supply function must set its own supply objectives and strategy.

Figure 2.1-1

### **The link between corporate strategy and purchasing & supply objectives and strategy**



*Your supply strategy will be based on your corporate strategy and its supporting supply objectives.*



As mentioned earlier, the supply objectives will relate to issues such as quality and innovation, availability and lead-time, supplier service and responsiveness, and cost reduction. Some examples of supply objectives are shown in the following table.

Figure 2.1-2

### **Examples of supply objectives**

Area	Examples of possible supply objectives
<b>A. Quality</b>	<ul style="list-style-type: none"> <li>◆ Ensure an internal customer satisfaction rate of at least 98% in terms of compliance of specifications with identified needs.</li> <li>◆ Always obtain standard (“off-the-shelf”) materials and components whenever these are capable of fully meeting our requirements.</li> <li>◆ Implement a system to continuously identify and evaluate the latest materials, components and technologies for use by our enterprise.</li> <li>◆ Identify at least three suppliers capable of working with our company to design advanced products in our product-line “X” that take advantage of the latest materials/technologies.</li> <li>◆ Ensure a performance reliability rate for the purchased items of no less than X%.</li> </ul>

<sup>1</sup> See *Module 1 – Understanding the Corporate Environment*

Area	Examples of possible supply objectives
<b>B. Availability</b>	<ul style="list-style-type: none"> <li>◆ Reduce average internal lead-time to 2 working days per order for standard requirements and to 10 working days per order for priority non-standard requirements.</li> <li>◆ Reduce average suppliers' delivery lead-time to 3 weeks per order.</li> <li>◆ Ensure an availability rate of no less than 99% for high priority items.</li> <li>◆ Implement a just-in-time system for delivery of materials.</li> </ul>
<b>C. Supplier service &amp; responsiveness</b>	<ul style="list-style-type: none"> <li>◆ Ensure that all suppliers of equipment and components employed in our products/services are evaluated as to their abilities to provide satisfactory responses to technical queries within 24 hours.</li> <li>◆ Ensure that all suppliers of equipment employed in our products/services are evaluated as to their capabilities to deliver urgently required spare parts within a period of 48 hours.</li> </ul>
<b>D. Cost reduction</b>	<ul style="list-style-type: none"> <li>◆ Ensure that the average price paid for standard materials is at least 2% below the prevailing published market price.</li> <li>◆ Reduce the average administrative cost per order by at least 10% over the next 12 months.</li> <li>◆ Ensure that all equipment purchased for the company's own use or employed in our products/services is evaluated before acceptance based on its life-cycle cost.</li> </ul>

These overall supply objectives will lead to developing specific supply targets for individual purchase items. You will be able to set common supply targets for many purchase items because they essentially fulfil similar requirements. However, you will need to set specific supply targets for those items that can have a particularly significant impact on your enterprise. This impact is gauged on the basis of how much your company's product-lines, projects and or ongoing operations – and thus its profits – will be affected if the item's supply targets are not met.

2.1 Linking supply & corporate strategy

2.2 The Supply Positioning Model

2.3 Single or multiple market segments

## 2.2 The Supply Positioning Model

### a) What is the Supply Positioning Model?

The Supply Positioning Model allows you to weigh the relative importance of each one your various purchase goods and services by taking account of the following factors:

- ◆ *Level of annual expenditure on the item.*



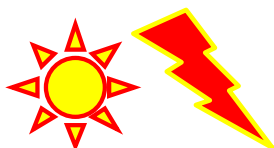
Here, we have been following Pareto's rule, which states that 20% of your purchase items are likely to take up 80% of your total expenditure. Consequently, the remaining 80% of your purchase items are likely to take up only 20% of your total expenditure. The more you spend on an item, the more important it will be to you because of the potential for cost savings.

◆ *Impact on the enterprise.*



As we have just seen above, this involves determining what the effect will be on your company – generally in terms of lost profit – if you are not able to meet your supply targets for the item.

◆ *Supply opportunity and risk.*

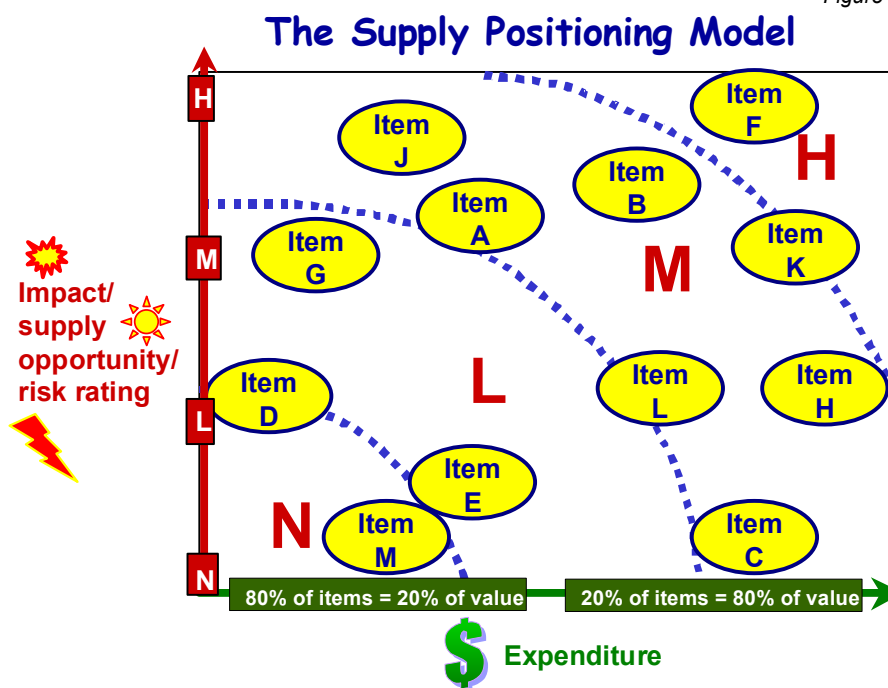


This indicator gauges the extent to which the item's supply market conditions will require you to make a particular effort either to avoid the risk of falling short of your supply targets and/or to take advantage of supply opportunities that will allow you to move ahead of the competition.

In the earlier Modules referred to above, we saw how to compare supply opportunity and risk to come up with a combined rating. By definition, this relates to conditions external to the enterprise. We also saw how this combined supply opportunity/risk rating could be wedded to the impact rating, which reflects conditions internal to the enterprise.

The Supply Positioning Model adds the expenditure dimension to this impact/supply opportunity/risk rating for each purchase item, allowing you to come up with a chart like the following.

Figure 2.2-1



Expenditure is plotted on the horizontal axis of this chart. As you move from left to right, the level of expenditure increases. The 20% of items that represent 80% of expenditure are located on the right-hand side of this axis. The other 80% of items that involve the remaining 20% of expenditure are located on the left-hand side.

The impact/ supply opportunity/risk rating for each item is plotted in relation to the vertical axis. Here, you can use any one of four categories: **H**, **M**, **L** and **N**. These categories represent the following:

**H** = High impact/ supply opportunity/risk  
**M** = Moderate impact/ supply opportunity/risk  
**L** = Low impact/ supply opportunity/risk  
**N** = Negligible impact/ supply opportunity/risk

By applying the **H** category, for example, what you are saying is that the item represents *both* a high impact for your enterprise and also a high supply opportunity or risk situation. As you progressively move down the rating, it means that the combination of impact and supply opportunity/risk decreases.<sup>2</sup>

The Supply Positioning Model serves two main purposes:

◆ *To guide you in prioritising your efforts*

You will not need to spend the same amount of attention on every purchase item. Some will be more important to you than others. This will depend on how much you spend on the item, what the item's impact is on your company, and its supply market conditions.

If you look at the above chart, you will see three curved dotted lines separating the chart into four zones, also **H**, **M**, **L** and **N**. Item F is located in the **H** (high priority) zone. It will therefore require the highest degree of attention. Conversely, item M is located squarely in the **N** (negligible priority) zone, and will require virtually no attention from you. All other purchase items are located somewhere in between these two extremes, and will have levels of priority commensurate with their locations on the chart.

◆ *To guide you in developing your supply strategy*

Your supply strategy will be very different from one purchase item to another. It will very much depend on the balance of factors that we have identified in the Supply Positioning Model. It is this particular dimension that will occupy us throughout this Module.

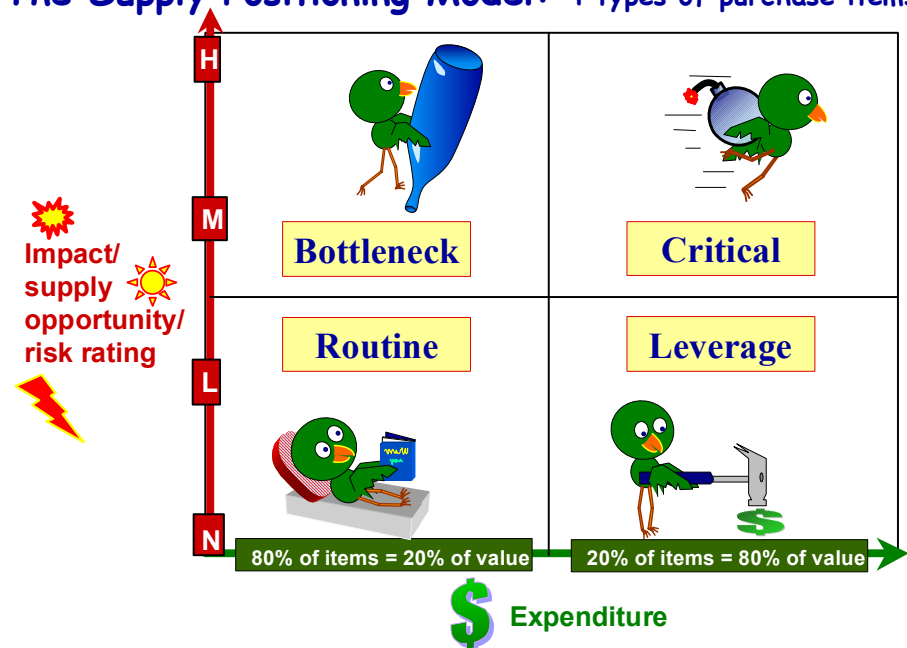
### **b) Breaking the Supply Positioning Model into Quadrants**

To understand how the Supply Positioning Model influences supply strategy, we will have to look at the model in a way somewhat different from the one shown above. We will now break down the chart into four quadrants, as illustrated in the following figure. Here, each quadrant represents purchase items with different sets of features. Each also calls for different approaches to their purchase and supply, as illustrated below by the little inhabitants of each quadrant.

<sup>2</sup> See *Module 2 – Specifying Requirements and Planning Supply* and *Module 3 – Analysing Supply Markets* for more details on the Supply Positioning Model.

Figure 2.2-2

## The Supply Positioning Model: 4 types of purchase items



We will now explore the characteristics of each of the four quadrants of the Supply Positioning Model. The characteristics described for a particular quadrant will be valid for most products and services positioned within it. However, there will occasionally be some exceptions, which we will be looking at later.

### □ Characteristics of the routine quadrant

This quadrant is characterised by a low level of impact/opportunity/risk (IOR) and low levels of expenditure.

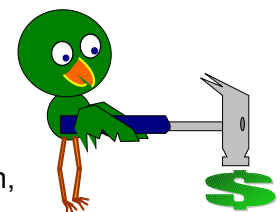


The low level of IOR reflects the standard nature of the products and services in this quadrant and their availability from many supply sources. Furthermore, the total amounts of money spent on these items is relatively low. Therefore, you do not have to pay much attention when purchasing them. Usually, companies have a number of standard items in the routine quadrant. Examples might include office stationery, cleaning services, or standard production inputs.

### □ Characteristics of the leverage quadrant

This quadrant is characterised by low levels of IOR combined with high levels of expenditure. It is similar to the routine quadrant in the sense that purchases will be for items which are standard products and easily available from many suppliers.

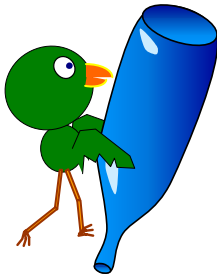
It differs from the routine quadrant because your annual expenditure level is relatively higher. This often means that your business is attractive to suppliers, which in turn may give you some “leverage” in terms of a better negotiation position, especially to hammer down prices as far as possible.



It is important to realise that what is a routine item for one company may be a leverage item for another. The level of annual expenditure (and not the price of the individual product) will determine the difference. Standard delivery vans are for example likely to be a leverage item for a delivery company but not for the average company.

The leverage quadrant is an attractive place to be. In the best of cases – depending on the size of your company – you may have significant bargaining power, and many suppliers competing for your business.

#### ❑ *Characteristics of the bottleneck quadrant*



Bottleneck items are characterised by high risk and low annual expenditure. They may be highly specialised and therefore only available from a few suppliers. This might for example be the case where the design of a product is based on new technology, or relies on components with very tight tolerances.

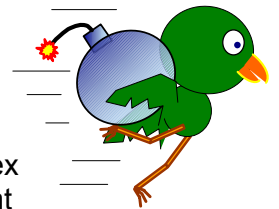
Non-technical items can also become bottleneck when they are subject to shortages of supply and their absence may affect your company significantly. In this case, it is availability that is the cause of high risk to your company, rather than technical issues.

The supply of bottleneck items will pose a significant risk to your company, but you have little ability to exert influence or control over their supply since your level of expenditure is low, and therefore not particularly attractive to suppliers. Consequently, bottleneck items will require your attention.

#### ❑ *Characteristics of the critical quadrant*



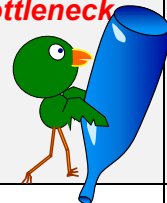
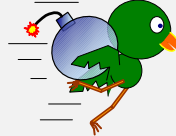
Like the bottleneck quadrant, the risks to your company in the case of critical items are significant. For these items, however, your level of expenditure will be higher. You may therefore have a greater ability to influence supply. Again, as for bottleneck items, there will typically be few suppliers.

Critical items are likely to be fundamental to differentiating your company's products or to achieving a cost advantage, and can therefore be key contributors to its profitability.



Examples of critical items might be components on which your end product depends, or a highly complex and/or customised input for a project. Key equipment in some industries is sometimes based on new technology and designed on an individual basis. In these cases, any deviation from the required performance could have serious consequences for the efficiency and effectiveness of the whole process.

Figure 2.2-3

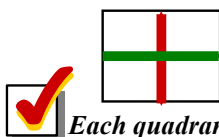
Summary of typical quadrant characteristics of the Supply Positioning Model				
	Routine 	Leverage 	Bottleneck 	Critical 
Impact/supply opportunity/risk to your company	Low	Low	High	High
Standard or non-standard purchase items	Standard	Standard	Often non-standard, but could be either	Often non-standard, but could be either
Number of suppliers	Many	Many	Few	Few
Level of expenditure for your company	Low	High	Low	High
Attractiveness of your business to suppliers	Low	High	Low	High



2.2-1

### c) Understanding the implications of positioning

It is convenient to split the Supply Positioning Model into the four quadrants that we have seen above in order to illustrate the importance that the position of your purchase items will have on your enterprise and – as we shall see later – the effect on supply strategy. This does not mean, however, that there are only four possible scenarios and four possible supply strategies. In fact, you have a whole range of scenarios and supply strategies available to you.

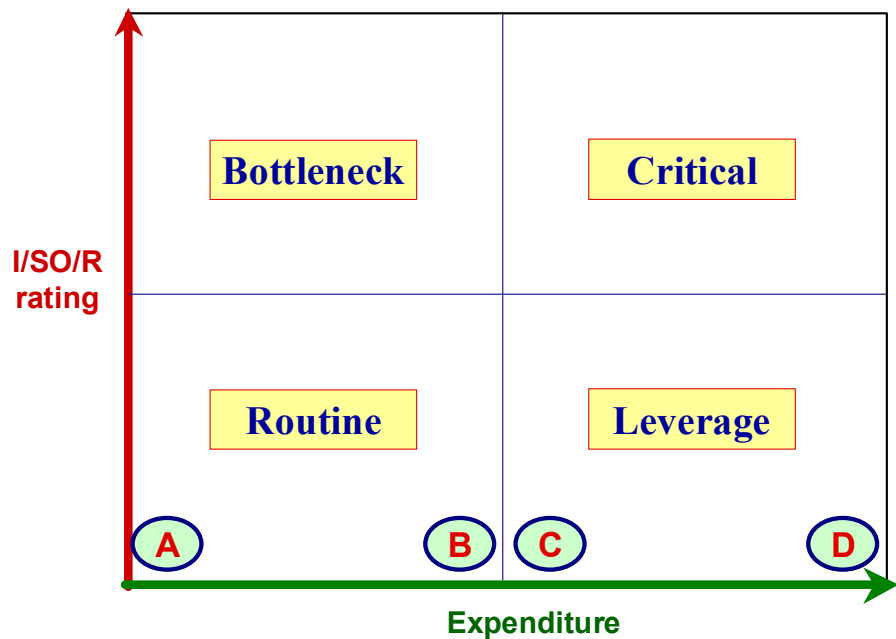


Each quadrant represents a “classical” situation. There are many variations possible as you get closer to other quadrants.

In the following figure, you can see that at point A the expenditure is very low and the risk is very low. This point represents a “classic” routine purchase item. Point B is within the same routine quadrant, but the expenditure level is much higher – almost as high as Point C, which is in the leverage quadrant. Thus, as you move towards the right within the routine quadrant, a purchase becomes less routine and more like a leverage item, until it becomes a “classic” leverage item at the right hand side of the model (Point D).

Figure 2.2-4

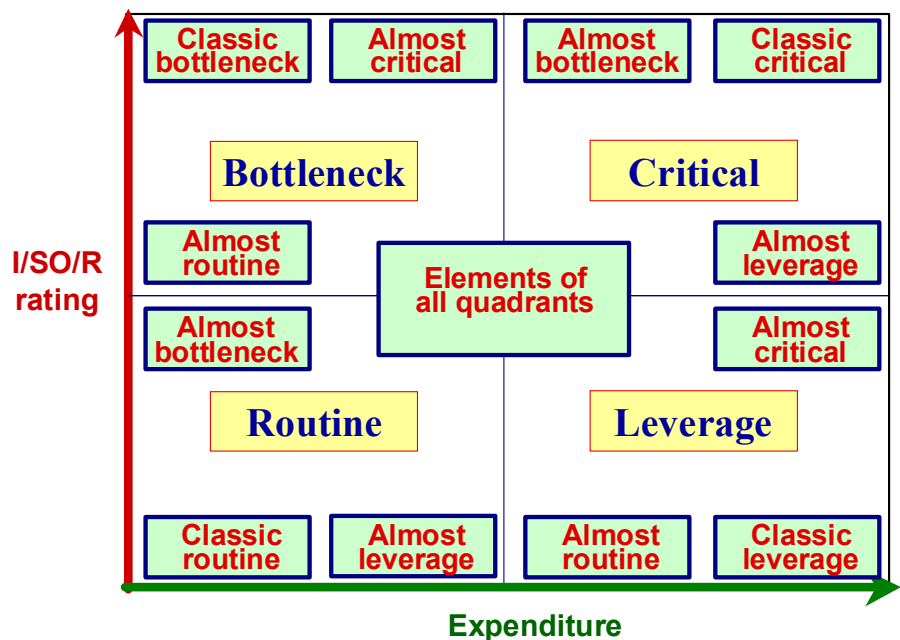
### The Supply Positioning Model - some examples



The following figure illustrates all of the variations possible as you move within one quadrant closer to another.

Figure 2.2-5

### Moving Around the Supply Positioning Model



We will see as we look at supply strategy in more detail that it varies with the position within a quadrant. Even though the supply strategy for a classic routine item will be quite different to the one for a classic leverage item, you would expect similar supply strategies to apply for

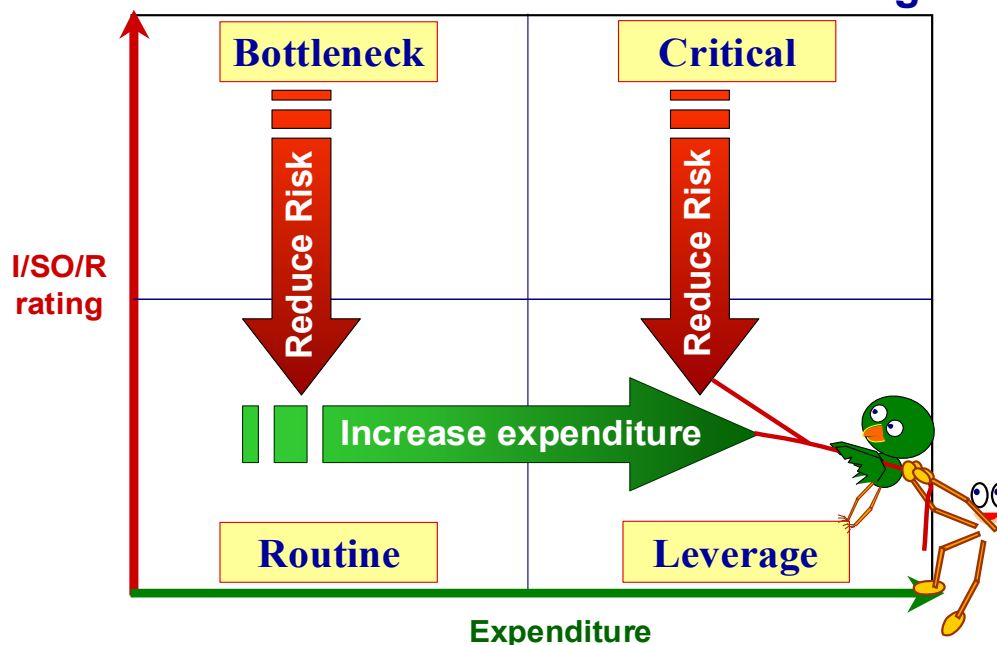
items located at points near the borders between two quadrants, even though they are in different quadrants.

#### d) Improving your supply position

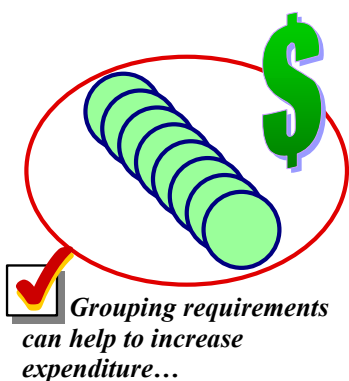
The ideal position on the Supply Positioning Model is in the bottom right corner – i.e. the classic leverage position. Here, you have a relatively strong bargaining power, and many competing suppliers may be interested in your business. You are therefore more likely to achieve highly competitive deals that fully meet your company's requirements, at a low risk. Your overriding objective should therefore always be to try to move purchases towards this position. This can be achieved either by reducing risk or by increasing expenditure.

Figure 2.2-6

### Your overriding objective... ...is to increase leverage!



Expenditure on a purchase item can be increased in a number of ways. For example:



- ◆ Group as many items as possible. For example, many suppliers now offer both office and computer consumables, so this type of purchases can be grouped together. You may also be able to combine servicing and maintenance with equipment purchases – rather than buying these services separately – in order to become more attractive to your supplier.
- ◆ If purchasing takes place on more than one site or for more than one purpose, you should make sure that any requirements that are common to more than one site or one group of users are added together and offered to the supply market as a single package.

- ◆ You may also be able to collaborate with other companies to form purchasing consortia. Here, certain common requirements of participating firms are pooled together to increase leverage with suppliers. Consortia exist for such things as office consumables and the purchase of utilities (electricity, gas, water and telecommunications). This approach may be particularly relevant to SMEs. For this reason, ITC has prepared a special supplementary module to the MLS dealing with this issue.<sup>3</sup>

Risk can be reduced in a number of ways, depending on the particular type of risk. For example:

- ◆ If the risk is technical, you should work with engineers and suppliers to try to eliminate or reduce the causes of the risk from the specification. Try to use standards whenever possible,<sup>4</sup> or use any available substitute products or alternative designs that offer a lower risk.
- ◆ Seek further internal standardisation of purchases to avoid excessive diversity and fragmentation.
- ◆ If the risk results from limited available sources of supply, it is possible that other sources of supply exist that you are not aware of. Undertaking an in-depth supply market analysis may reveal additional sources and so reduce the risk.
- ◆ A further way of increasing the availability of supply is to work with firms that do not currently supply the product or service in order to develop their capability to do so.



*You can reduce risk by identifying new sources of supply and developing supplier capabilities.*



2.2-2

You should review such opportunities for increasing expenditure and reducing risk before developing your supply strategy for a particular item.

2.1 Linking supply & corporate strategy

2.2 The Supply Positioning Model

2.3 Single or multiple market segments

## 2.3 Single or Multiple Supply Market Segments?

Supply market segmentation is usually carried out on the basis of geographic location, technology and supply channel. Different segments (e.g., different countries) can represent different levels of supply risk and opportunity.

If a low-risk supply market segment exists that can reliably meet all of your requirements, it will be – in the majority of cases – most cost-effective to use a single segment. Using multiple supply markets has the following disadvantages:

- ◆ The more you split your requirement amongst supply markets (and therefore amongst suppliers), the less leverage you will have in each individual supply market. An exception to this

<sup>3</sup> See *Module 14 - Grouped Purchasing for SMEs*.

<sup>4</sup> Standards are covered in detail in *Module 2 – Specifying Requirements and Planning Supply*.

would be if the same supplier (e.g., a multinational) were present in all of the supply markets that you are considering.

- ◆ If the supply market segments are geographically based (i.e., different countries), there will be additional costs and inefficiencies associated with having to “move up the learning curve” (developing an effective relationship) with more than one supplier firm. For example, there will be more than one culture to adjust to, different sets of problems to resolve, increased travel costs if supplier visits are required, and so on.

If a low risk supply market segment that can reliably meet all of your requirements does not exist, you may wish to source from two or more segments. This will allow capacity to switch supply markets in case of disruption to supply.

Following, are some questions to help establish whether you will need to source from more than one supply market segment:

- ◆ Can one segment reliably meet your capacity requirements?
- ◆ Are there structural reasons that would prevent you from sourcing from only one supply market segment? For instance, if your company has multiple sites that are geographically spread out, the high cost of transport or the need for frequent face-to-face interaction with suppliers might preclude using a single geographic segment<sup>5</sup>.



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<sup>5</sup> This is covered in more detail in *Module 3 – Analysing Supply Markets*.