

Procurement strategies & Kraljik Matrix

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Procurement strategies & Kraljik Matrix

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1.Introduction

This report will document a brief history procurement. It will then comment on procurement, from an organisational perspective and key areas of procurement which need to be considered, the scope of procurement and how the 3 E's add value in procurement process.

Thereafter, Kraljic's Classification Matrix, Purchase Importance v Supply Risk, classification segments will be analysed and applied to Toyota's, 2000 – 2010, procurement strategy 'Construction of Cost Competiveness in the 21st Century (CCC21)'.

1.2 The History of Procurement

Procurement has evolved throughout the years, 3,000BC in Egyptian times where it was known as materials management. Over the next approximately 4,800 year's procurement practices were developed, on a small scale. Citation Needed

'Material man' was a term used, according to Babbage (1832), as quoted in, Nolan (2019) coined in the mining sector as a person who chose, bought and tacked goods and services. This brought the awareness that a centralised system was needed to focus solely on procurement activates in order to manage organizational requirements.

Four years later, in 1886, the procurement function was labelled. In the United States, as the 'supply department'; the role of which was to specifically procure, from more developed parts of the country, goods and services for less developed areas (Kirkman, 1887, as quoted in, Nolan, 2019). Good point Good source

The procurement function moved from a strategic function, due to national and international shortages, to a cost driven clerical function during the war time period. As time went by, clerical staff were trained in procurement, helping the procurement function to regain its role as a departmental need.

It was not until the 1990's that procurement became a 'strategic resource'. This was the start of the procurement revolution; it focused solidly in creating supplier relationships to develop more effective business relationships (Nolan, 2019). Good point

Nowadays, effective procurement substantially influences an organizations 'bottom-line' making it an essential part of any business strategy or function.

2.Procurement

Procurement can be defined as a systematic plan of process in order to fulfil the requirements of a supply chain; this fulfilment can be in the form of products or services. The procurement department of an organisation must fulfil demand in the chain and ensure that there are sufficient supplies of products or services; supply of these product and services requirements need to be fulfilled at the right price, required quality, the right place, and at the right time, so that operations can be a success in the overall supply chain.

Key areas that procurement needs to be concerned with Identifying the purchasing objectives and supply management (CIPS and NIGP, 2012).

- Specification
- Options available in the marketplace (make or buy assessment)
- Develop a strategy/ plan (local or global), risk mitigation.
- Pre-procurement test
- Develop documentation (agreement and terms conditions along with detailed of the specification)
- Supplier selection
- Issue ITT (Invitation to Tender)/ RFQ (Request for Quotation)
- Evaluation and validation of Bid/Tender
- Business contract and implementations
- Logistics and warehouse consideration
- Review contract performance against established Key Performance Indicators (KPI)
- SRM and SC management
- Asset management (end of life)

Good source

(Chartered Institute of Procurement & Supply, 2014)

3.The scope of Procurement

The procurement department aims to create an alliance between departments, to ensure that organization objectives are a success; an alliance between departments will enhance the performances all function in the organization. Procurement involves the acquisition of an organizations tangible and intangible needs.

The procurement department scope includes:

Utilizing modern e-procurement techniques will reduce cost, cycle time, processing and orders time, and make the transaction more efficient. Good point

Distinguishing new source of raw material, suppliers of goods or services, in order cost effectively fulfil demand. This also involves looking for new products, new to market, to add value to an organizations offerings.

Early involvement in the process of design a new product or require new service.

Develop a partnership with a key supplier to facilitate a purchase, payment terms, credit facility for routine purchase, and a leverage position in the negotiation (Rushton & Croucher, 2017).

4. Obtain value-for-money with the 3 E, s:

4.1 • Economies- by spending less and minimising the cost of inputs. Caution must be taken that products which cost less, still offer the same or better, in areas of: quality, quantity, delivery, reliability and terms of business.

4.2 • Efficiencies- spending well; doing things the right way. This requires an integrated and holistic approach between all departments to make sure what is sourced is fit for purpose.

4.3 • Effectiveness- spending wisely, rather than simply buying the cheapest. As with Economies, caution must be taken when choosing supplier (National College for Teaching and Leadership, 2019).

4.4 'Smart acquisition' considers the "whole-life nature" of the "acquisition cycle, which includes its in-service support" (Uk Parliament, 2001). According to the National College for Teaching and Leadership (2019) smart acquisition is needed in order to control inventory levels and manage waste.

5. Kraljic spelling matrix

The Kraljic's Matrix (1983) is used to accurately and effectively analyse supply chain segmentation; using risk and importance levels mapped against risk and profitability (Caniels & Gelderman, 2005).

5.1 Strategic items (supplier controls) – Supply management

Strategic items are items that the organisation or business is reliant on in order to retain their competitive market advantage. Strategic items normally have a high impact on the overall

operations because they reflect or impact on customer experience and produce quality. So, if you take the strategic items, based on quality, and an organisation changes supplier, based on a lower price, but that is of lesser quality, the supplier risks losing their reputation as a quality supplier, and reflect negatively on customer experience (Mangan & Lalwani, 2016).

If you have one single supplier, the advantages are that you can build a relationship of mutual trust and only have one supplier account to manage. However, there can be high risks involved with this strategy. Creating a close working relationship, by focusing on long-term partnerships, and monitoring your supplier, can help mitigate these risks (Kraljic, 1983).

5.2 Bottleneck items (supplier controls) – Sourcing management

Bottleneck items give the procurement department the ability to reduce costs and improve profits as there are many suppliers to choose from. Therefore. This can be profitable for the organisation, as the items are not critical, as there are several suppliers to choose from. In addition, due to supplier numbers, there is more negotiation, therefore, price reductions can be gained (Mangan & Lalwani, 2016).

5.3 Leverage items (buyer controls) – Material management

Relationship for the suppliers of leverage times, even though they represent a small proportion of the supply chain, have to be well managed to avoid disruption in the supply chain because of the importance that the items or products have on overall operations. These items could be considered niche purchases which have few suppliers; therefore, the relationship becomes a balance of supply versus cost (Chartered Institute of Procurement & Supply, 2014).

5.4 Non-Critical items (buyer controls) – Purchase management

These are items that can be procured from a large number of suppliers, do not require supply chain analysis, and can be automated with the use of a computerised stock control, automatic reordering system (Caniels & Gelderman, 2005).

6. An analysis of Toyota procurement strategy, using Kraljic's Supply Matrix, 2000 – 2010

Toyota, 2000, introduced a new programme, which was implemented by their Vice President, Katsuaki Watanabe called the Construction of Cost Competitiveness in the 21st Century (CCC21) programme. This programme was designed to reduce costs, waste and administration time.

6.1 Toyota operates four-tier supplier classifications: Tier-one, Tier - two, Tier-three and Tier – four.

In the following sections, four tier supplier classification, will be analysed, using secondary research, against Kraljic's Matrix – supply risk and purchase importance: Strategic, Bottleneck, Leverage and non-critical item declassification (Kraljic, 1983).

6.2 Tier -one classification

Are small number of large specialist suppliers, such as Bosch and Delphi, which have a 1:2:1 relationship with Toyota as they supply critical components for supply chain in the form of large integrated systems (Andrews, et al., 2011).

These suppliers fall into the 'Strategic Item' category, because these items are of high purchase importance and high-risk supply (Kito, et al., 2011). Good point

6.3 Tier -two classification

Tier two suppliers provide individual parts or part assembly services to Toyota directly or to their tier one suppliers.

These suppliers fall into the 'Bottleneck' category, because these items are of low purchase importance and high-risk supply. Good point

6.4 Tier -three classification

Tier three are specialist supplier who often supply just one component for tier two suppliers. These suppliers fall into the 'Leverage' category, because these items are of high importance but and low supply risk (Andrews, et al., 2011).

6.5 Tier –four classification

Are suppliers that produce non-speciality, volume products to the supply chain. These suppliers fall into the 'Non-Critical Item' category, because they represent supplies that are of low risk and low purchase importance (BM Corporation , 006). Good point

7. CCCL21 programme

At the start of the CCCL21 programme, Chinese outsourcing began. The aim of which was to save 30% on the cost of 180 key parts needed by Toyota. The supply and importance of these

parts, at first investigation, fall into the strategic classification because their purchase is of high importance and, therefore, can be at risk in the supply chain. However, because China's economic, innovative and manufacturing explosion of the last 20 years, there are many suppliers, with the capability and flexibility to produce and supply high volume items and therefore reduced supply costs, thereby, making these items leverage items giving Toyota's procurement team more buying control because of their need for volume supplies, as volume V costs (Andrews, et al., 2011).

Involvement in the early stages of manufacturer gives the procurement team leverage because it avoids errors in design and production. The involvement with suppliers and manufacturers can create a holistic involvement, where they can work together to reduce costs that will not compromise the quality of the goods (Toyota Industries Corporation, 2019). By working with the supplier, they can add value to the procurement process as involvement of suppliers can lead to supplier provided, pre-assembled items rather than individual components. Toyota adopted this process, working with their suppliers, they not only standardized parts across ranges, e.g. reducing air condition vents to 3 types from 27 saving 28 percent in costs, but also in reducing the number of components that were needed to produce a part. These, newly standardised parts fall into the 'Leverage' classification because they are of high importance but are a low supply risk (Andrews, et al., 2011).

In 2005, due to the spiralling cost of steel, Toyota's innovation team reduced the number of steel parts required to 500, from 601. The procurement team, therefore, had less, but more complex items to source. These items fall into the 'Bottleneck' classification because Toyota needed supplier reliability, using a specific material (steel) at a competitive cost. It could also be considered that these items fall into the 'Strategic Item' classification because Toyota required the components to be available long term, using a high value material from established global suppliers (Toyota Industries Corporation, 2019). Good analysis

In addition, Toyota commenced their bold targeting, 'innovation program', with the aim of lowering costs, over the following five years, by 30% which also involved reducing, by 50%, the number of automobile components. Toyota used Lower Country Economy outsourcing, using Chinese suppliers, in their procurement cost saving strategy, in order to reduce costs by more than \$2.5 billion a year (Andrews, et al., 2011). This cost saving, outsourcing strategy would make these parts fall into the 'Strategic' classification because the purchase is of high importance because they are high volume, price competitive items; however, they are at risk in the supply chain because of supply chain relationship, international politics and the country's economic status and stability (Eriksson & Lerenius, 2004). Good point

8. Conclusion

The procurement process has the potential to add to an organisation, should not be taken lightly or seen solely as a purchase function, as there are many other functions involved; such as supplier selection, market analysis, developing strategies between organisation and customers, legal agreements, the bidding process, logistic and warehouse considerations, review process of business relationships, and asset management.

The procurement team ensures that both services and materials flow easily and effectively, by selecting the right supplier, the right quantity, in the right place at the right time. Therefore, this is the focus of the procurement department, to support the organizations goal.

The role of the procurement team is also to build relationships between internal departments, so each department works together, to facilitate the organizations goal of operational costs reduction.

This is done by implementing a 'Smart Acquisition' process which reduces unnecessary spending, spending efficiencies and effective purchasing.

The Kraljic's Matrix creates a platform for purchase importance and supply risk analysis. This matrix looks at four specific areas: 'Strategic Items' approach which fall under supply management, the 'Bottleneck Item' approach which falls under sourcing management, 'Leverage Item' approach, which falls under materials management and 'Non-Critical Item' approach, which falls under purchase management.

The Matrix offers procurement teams a visual way of classifying in purchase importance with supply risk, thereby, recognising where potentials risks may occur in the supply chain and mitigate these risks by using fair business practises to build supplier relationships which realise amicable and mutual benefits.

Toyota uses a four-tier supplier classification model which categories in terms of importance. As cost saving measure, between 2000 and 2010, Toyota worked with existing and new suppliers to reduce supply costs. This resulted in the procuring some product from China, working with existing suppliers to reduce component parts, standardizing parts across their range of automobiles and creating innovation programs which lead to a total cost saving of \$2.5 billion dollars a year.

Using Kaljic's Matrix to analyse Toyota's procurement strategy, during this period, it is evident that Toyota used the 'Smart Acquisition' approach to their full advantage, making considerable savings which helped them maintain their market competitive advantage.

Good conclusion

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GRADEMARK REPORT

FINAL GRADE

84/100

GENERAL COMMENTS

Instructor

Extremely well researched with excellent use of credible, reliable and relevant sources.

A very good knowledge and understanding of strategic procurement is evident throughout the report.

Very good analysis of an extremely relevant organisational example.

Well structured with arguments portrayed in a clear, coherent manner.

Excellent work. Well done

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Good conclusion

Well concluded

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