

START-UP BRIEFING



Highlands & Islands
ENTERPRISE

Purchasing

● When 'company doctors' are called in to save businesses, the first step is often to renegotiate all the supply contracts. Managers watch in amazement as hard-nosed suppliers agree to knock five to 15 per cent off their prices, giving cost savings that can transform a company's prospects.

For start-ups, too, effective purchasing is a fast and simple way to boost profits and improve efficiency and quality.

This briefing explains:

- ◆ How to decide what to buy.
- ◆ How to pick the right suppliers.
- ◆ How to get the best out of your suppliers.

1 Specify what you want

A Identify the most **important features** of the goods or services being supplied.

Decide what you want your purchase to do, and how well it should do it. Agree details with the potential supplier, and set them out in a specification. This might include:

- ◆ Size.
- ◆ Quality and appearance.
- ◆ Technical features.
- ◆ Delivery schedule.

B Do not **over-specify**.

Unnecessary or unreasonable specifications are counterproductive.

- ◆ Costs will be increased.
- ◆ Suppliers will be irritated.

C Agree everything **in writing**.

The specification and the terms you agree

will form the basis of the purchase contract.

- ◆ Relationships often break down because of misunderstandings. Having a written contract avoids this.

Verbal agreements are also binding in law, but are difficult to prove.

- ◆ Unless you propose your own terms, you may be agreeing to the supplier's terms.
- ◆ All the specific terms agreed under points **3E** to **3G** should be included in the written contract.

The supplier will soon learn what needs to be done to achieve the standards you require.

Improvements will feed straight through to your own product or service — fewer delays, less waste, fewer complaints, and more customers.

FURTHER HELP

There are other Start-up Briefing titles that can help you. These briefings are referred to in the text by name and by the code given to each briefing. For example, SuB 12.

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2 Supplier selection

- A Suppliers** should be easy to find, through:
- ◆ Existing suppliers or competitors' suppliers.
 - ◆ Trade journals, trade associations and Chambers of Commerce.
 - ◆ Directories — in the library or on the Internet, such as www.yell.com.
 - ◆ Business directory websites, such as www.tradeuk.com or www.scoot.co.uk. The Used Equipment Network (www.buyused.com) has used machinery, from aircraft to X-ray scanners.
 - ◆ Suggestions from friends and employees.
- B** Make up a **shortlist** and write to each supplier, explaining your exact requirements.
- ◆ Ask suppliers to send you product details, price lists and other relevant information.
 - ◆ You can often obtain better terms by letting suppliers know that they are competing for your order.
- C** Pick out suppliers you believe can offer the **quality** of product and service you need. Compare them in terms of:
- ◆ Product suitability and reliability.
 - ◆ Reputation, based on references.
 - ◆ Quality and flexibility of service.
 - ◆ Location and ease of communication.
 - ◆ Speed and frequency of delivery.
 - ◆ Price range and order size.
- D** For **long-term** supply contracts, make the effort to visit those suppliers that seem to meet your quality standards. To assess how they are likely to perform, ask yourself:
- ◆ Are they professional, or sloppy?
 - ◆ Do they have too much work, or not

An expert's tips on purchasing

- ◆ *Buy the product that offers the benefits you want. Never buy on price alone.*
- ◆ *Focus your price-cutting efforts on those items you spend most money on.*
- ◆ *Focus your quality-boosting efforts on those items which most affect the quality of your own product.*
- ◆ *Keep accurate records of all purchases.*
- ◆ *Do not 'squeeze' a supplier if you plan to buy regularly from that source.*
- ◆ *Look for opportunities to pay using your product instead of cash. ('I'll give you some furniture, if you do my accounts.')*

enough?

- ◆ How eager are they for your business?
 - ◆ Do they have the necessary equipment and space to cope with your order?
 - ◆ Do they appear to be financially stable?
- E** Get **quotes**, including details like discounts and payment terms, to use in negotiations.
- ◆ Ask how often prices will rise, what influences will cause them to rise, and how you will be notified.
- F** Once you have narrowed the choice down to two or three suppliers, **negotiate** prices, discounts and levels of service (see **Negotiation**, SuB 13).
- ◆ For a healthy long-term relationship, do not negotiate too hard a price at the expense of quality.

3 Supplier relations

- A** Put most of your **effort** into:
- ◆ Supplies you will spend the most on — five or ten items may account for 90 per cent of the money you spend.
 - ◆ Supplies crucial to your production.
- B** Avoid **over-dependency** on one supplier.
- ◆ What happens if the supplier goes bust?
 - ◆ Alternative suppliers provide competition.
- C** Give most of your orders to just **a few suppliers**.
- ◆ If appropriate, ask for bulk or cumulative discounts (eg if you order 5,000 units in the next year, you get a five per cent discount on all orders during that period).
- D** **Treat suppliers well** and they will treat you well.
- ◆ Keep them up to date with your needs.
 - ◆ Build a relationship of trust.
 - ◆ Ask for their views and ideas.
 - ◆ Consider establishing long-term partnering arrangements with your best suppliers. Co-operate to improve the goods and services supplied and relevant procedures and systems (eg ordering).
- E** Agree in advance what will happen if the supplier's goods are **faulty**.
- ◆ Will the supplier replace the one faulty item or the whole batch?
 - ◆ Will replacement supplies be delivered immediately, or will you get a credit note?

- ◆ Will replacement goods be free? Who will pay for delivery?
- F** Ensure that the supplier fits in with your ordering **systems**.
- ◆ Will the supplier agree always to quote your order reference?
 - ◆ How will you be able to avoid paying for all the goods when part of a delivery is incorrect?
- G** Agree on **payment terms**.
- ◆ Payments in advance should generally be avoided, especially if you are unsure about the supplier's creditworthiness.
 - ◆ Ask for a discount for early payment.

4 From order to delivery

- A** How much **stock** do you need to hold?
- Holding stock ties up money and increases warehousing costs. Aim to minimise your stock levels and make delivery of supplies the supplier's responsibility.
- ◆ How reliable are the supplier's deliveries?
 - ◆ How long does delivery take, once an order has been placed?
 - ◆ What will happen if you run out of stock?
 - ◆ How much storage space do you have? Will the supplier hold stock for you?

Faceless customer

Bridget Biddell's toy-making business got off to a flying start. But, as it grew, late deliveries, substandard products and bungled paperwork began to cause problems. Her production manager was always calling the suppliers to complain about something or other.

When Bridget took up the LEC's offer of a free 'company health check', the adviser suggested she go and discuss the problems directly with the suppliers and meet all the individuals involved.

She did. She met the managers and salesmen she already knew. Then she met the machine operators who made the components, the warehousemen who packed the goods and the clerks who did the paperwork. With each person, she discussed the problems that individual could personally help to solve.

It worked. The machine operators took more care when a batch was 'for Bridget', as did the warehousemen and the clerks. They were all more than willing to help, but the faceless production manager, who complained all the time, had merely irritated them.

- B** How will you decide to **order**?
- ◆ For many small companies, a weekly stock check and ordering routine is sufficient. Devise your own system, reflecting the actual needs of your business.
- C** How can you avoid **late deliveries**?
- ◆ Make delivery terms clear, in writing, when you place your contract.
 - ◆ Ensure your supplier is familiar with the time constraints that affect your business.
 - ◆ Keep track of what deliveries are arriving when. Chase them up immediately if they are late, contacting the supplier's managing director, if necessary.
 - ◆ Always check what has actually been delivered before signing the delivery note.
 - ◆ Agree delivery performance standards as a condition of the contract.

5 Look at the alternatives

Before buying any equipment, consider the various possibilities. Different choices will alter the amount of capital you need to put into your business and affect your costs.

Take the example of a furniture maker, starting in business and needing a supply of round, turned table legs.

The start-up's managers have several options:

- A** Outright **purchase** of a new lathe.
- ◆ Can this new business afford to tie up its cash in capital equipment?
- B** Purchase of a **secondhand** lathe.
- ◆ Will the machine be reliable?
 - ◆ Is there a guarantee?
 - ◆ Can the seller prove ownership of the machine?
- C** **Hire purchase** of a lathe.
- ◆ Hire purchase is a way of buying without having to pay for your purchase in one go. Payments of capital and interest are typically spread over three to five years. It is like taking out a loan secured on the equipment.
 - ◆ Compare the cost of hire purchase with that of other finance, such as a bank loan (see **Financing your business**, SuB 15).
- D** **Lease** of a lathe.
- ◆ A lease allows you to pay for the use of something without buying it. The equipment can be returned to the

► It is essential to understand the importance of contracts in purchasing. See **Business law and using a solicitor**, SuB 28, and **Negotiation**, SuB 13.

► For the DTI's free booklet, 'Supplying the challenge: a management overview', call 0870 1502 500; for the CBI's publication, 'Partnership sourcing and action — 20 case studies' (£10), visit the website www.pslcbi.com.

owner at the end of the lease period — usually three to five years.

- ◆ Check the lease's small print.

For example, do you need to give notice at the end of the lease and continue paying for three months?

E Subcontracting out the lathe work to an outside supplier.

- ◆ Will the supplier work to the required standards and timescales?
- ◆ Can a subcontractor supply the quality that is needed at the right price and still make a profit?

F Buying in ready-made round table legs.

- ◆ Do these meet the quality requirements?
- ◆ How do the costs compare?

Be careful when buying equipment as part of the purchase of premises, particularly when taking over leased equipment. Check the exact terms of the lease and make sure all the equipment is transferred into your name.

6 Equipment specifications

A If you do buy or lease equipment, think through your **requirements**. For example:

- ◆ Technical specifications — output per hour, accuracy, wastage, number of relevant applications, controls, safety, reliability, and the machine's life expectancy.

Consider how you will use the equipment.

For example, will you need a high-quality copier that reproduces small print clearly?

A more expensive piece of equipment may save you money in the long term.

- ◆ Compatibility — with other equipment, available power supplies and your premises (especially if the building is old).
- ◆ Guarantees — will the seller still be around to honour the promises made now?
- ◆ Technical support — assume everything will go wrong.
How soon will help come? Will spare parts be available? How experienced are the engineers? How steep will the charges be?
- ◆ Technical skills or training required — will you need to hire specialist staff?
- ◆ Options for expansion and upgrading — or will the equipment soon be obsolete?

Which of these requirements are essential?

B What are the true **costs**?

- ◆ Purchase price.
- ◆ Delivery and installation costs.
- ◆ Maintenance costs — service and repairs, including parts.
- ◆ Running costs — power, lubrication, cooling and consumables.

For a major purchase, gather enough data to put together a realistic life-cycle costing.

Beware of long maintenance contracts. Read the small print and make the supplier spell out your present and future commitments.

7 Office supplies and services

A Purchasing office **supplies** is often regarded as unimportant. As a result, many start-up businesses end up paying far too much.

- ◆ Make the initial choices yourself. Then give one person responsibility for reordering.
- ◆ Do not overstock. Almost all suppliers will offer you next-day delivery.
- ◆ Office supplies specialists (eg Office World, 0800 5000 24) will usually beat the prices on offer at your local suppliers.

B Contracting out office **services** can be more cost-effective than using permanent staff.

- ◆ Examples include cleaning, maintenance, security and computer services.
- ◆ Potential benefits include lower costs, more flexibility and access to continually updated technical expertise.

EXPERT CONTRIBUTORS

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