

"Transaction costs" is a concept that regards how to calculate the cost of a product / service. It is based on the concept of transaction, which is the exchange of goods & services between two actors.

The idea of transaction costs is that the cost of a product / service can't be merely considered as the purchasing price, but other important factors have to be taken into account. Other than the actual cost of the purchasing, transaction costs also consider three elements of a transaction:

- the costs related to finding a supplier for the product / service needed.
- the cost related to stipulate the contract with the selected supplier.
- the cost to supervise, control and manage the relationship with the selected supplier.

For an easier explanation we can divide transaction costs in:

- pre-transaction stage
- transaction stage
- post-transaction stage

Examples of the previous stages are, in the same order above:

- the cost that a company may face to do a market research to have a better vision and knowledge about the available supplier on the market, cost that can be sustained internally paying people of the company or externally making use of specialized market research companies.
- the cost that a company may face for stipulating the contract, negotiating and finding solutions to the possible issues, other than the cost sustained to pay lawyers and contract manager to stipulate the contract.
- the cost that a company has to face to monitor the performances of the supplier through inspections, audits and other tools. It is also comprehensive of all the indirect cost deriving from the product / service bought, such as quality, etc that the company will face with the product bought.

Transaction cost vary on three different elements:

- the frequency of the transaction
- the specificity of the investment
- the uncertainty;

At the increase of these three elements the transaction costs increase, because:

- more frequent transactions mean more time and money spent in the relationship
- more specificity means more risks for the supplier and more costs that he has to sustain specifically for our relationship
- more uncertainty means that the future relationship and context are uncertain and therefore is hard at the present moment to stipulate reasonable contracts

The usefulness of transaction costs is in particular in the decision for outsourcing or not a product/service (one of the different possible indicators)

The more the transaction costs are high (because are high the three elements seen above) the more arguable is to maintain the product/service in-house.

a) Services are extremely important for companies and often do not receive the treatment and attention they deserve. Buying services is important because they are needed for the proper functioning of a company and represent more and more an increasing part of the purchasing spending of a company. Buying services is also important because sometimes companies do not have the internal resources, knowledge or expertise to provide them. Another important aspect is that buying services allow companies to focus more on their core activities, without having to spend time and energies on certain non-core activities.

b) Services can be classified in several different ways:

- Pareto, with the 80/20 rule, to identify the services that contribute more to the profit of a company or the one that are more costly.
- Kraljic matrix, by which services can be classified in 4 categories (strategic, leverage, routine, bottleneck) based on the profit impact and supply risks. (Explored in more details in answer b.c)
- Company environment (financial, logistic, marketing, maintenance, etc), basically based on the "functions" in the company that are engaged for.
- Professional services, shop services and mass services, based on the number of people involved in the service, how many people they can reach and the attention to the single customer.

Classifying services is really important because knowing what service a purchaser is dealing with is fundamental to understand how to treat it, how to define which strategy to use with it, how many suppliers are necessary and available, what kind of relationship have with them, identify the target user and know better what they expect from the service and so on.

c) Services are different from goods in specification, contracting and selection because they are completely different entities. Services are not physical, cannot be stored, their production and degradation are simultaneous and technical specifications are hard to define.

From the fact that services are difficult to precisely define, measure and evaluate, usually they are specified through the expected performance they are going to provide. The contracting that better suit services is an output / outcome performance, in which the supplier guarantee a certain performance to be provided to the buyer. It is here important to define KPIs that both parts agree on. Only in this way an evaluation is then possible, to understand if the supplier reached or not the contracted service.

Productivity and innovativity are two important concepts of a supplier relationship. They are related to resource interfaces, which are the modalities through which a supplier and a buyer interact. There are four types of resource interfaces:

- Standardized, use and product are but remotely related
- Specific, product adapts to use
- Transactional, use adapts to product
- Interactive, use and product work together

Productivity relates to how the interface is good in terms of resource use, how efficient it is

Innovativity relates to how the interface lead to innovative solutions and creativity

- Standardized interfaces have high productivity but low innovativity, because the buyer buys a product which is produced in large scale to be efficient, for which innovativity is therefore low, because that would mean expenses for the supplier and no negative effects on productivity.
- Specific interfaces have high innovativity, because the supplier is pushed to adapt new solutions to satisfy the customer, but productivity is lower, because the investment is specific.
- Interactives are high in both aspects, because buyer and supplier collaborate to find innovative solutions, trying to keep a good productivity through long-term relationships.

a) Involvement in buyer-supplier relationships refers to developing a relationship of trust and information and ideas interchange in a way that both parts gain a certain advantage. The involvement may be an early supplier involvement, through which the supplier is invited to collaborate with the buyer's company in the ideation, creation and development of a new product. Another kind of involvement regard the processes in a company: a supplier may contribute giving ideas and suggestions on how to develop a better process. Involvement works on both sides of the relationship and may lead to lower costs in different aspects (logistics, product development, manufacturing, etc.), lower lead times (logistics, product development, etc.) and new products and solutions to increase the revenues of the company and therefore of the supplier itself.

b) A straight buy is a purchasing situation in which a known product is bought from a known supplier. In this situation the uncertainty of the purchase is low and usually it is a wise idea to adopt e-procurement solutions, from the fact that standardized "frameworks" can be here used and through internet and digital catalogues the handling cost associated to these products is minimized. An example are cleaning materials or office furniture, which are bought on a regular basis, without relevant changes and can be therefore bought through e-procurement.

c) An hybrid purchasing structure is one in which characteristics of a centralized and decentralized purchasing structure are combined. Therefore a centralized department is present and its role is to make agreement with supplier about products and services shared among different units in the organization. Its role is also to stipulate general framework agreements that the buyers in the different units may use to make their specific purchases (e.g. the central unit agrees with suppliers on pricing method, quantity discounts, payment terms, quality, etc. and then the single units specify the quantity of the particular item desired). It is therefore clear how the single units have the power to raise as in a decentralized

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Classification and analysis

a) Summary market research: the gathering of information regarding aspects that can influence the purchasing of goods and services in the short and long term. It can be qualitative (e.g. consulting experts about general trends in a market) or quantitative (e.g. making use of statistics from data centers) or combined. It can be related to product services, suppliers, or systems and procedures. Another classification is macroeconomic (e.g. a region, how the taxes and incentives in that region are, how the labour cost in that region is), mesoeconomic (e.g. a particular industry, how technology is evolving in a particular industry such as IT or automotive) and microeconomic (e.g. a particular supplier, how the strategy of this supplier is, how it is evolving).

Purchasing research: research made to find suppliers that are able to provide the product or service required by the company. Therefore it is a specific research aimed at finding players in the market able to satisfy the needs of the company.

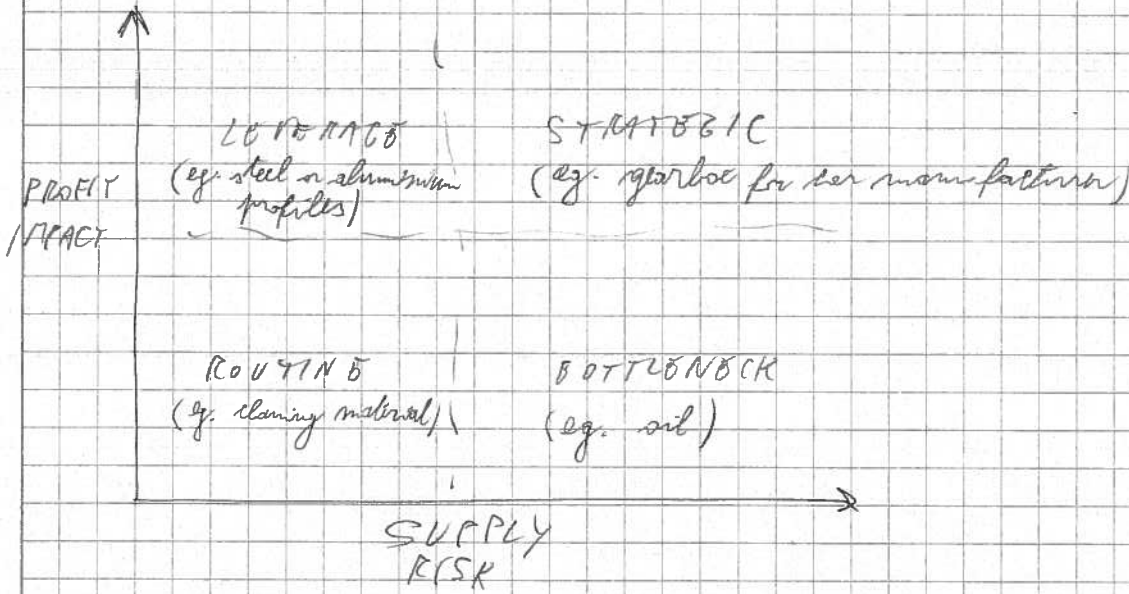
b) A portfolio analysis is an analysis regarding the categories of products/services a company buy from its suppliers. Kraskic method is based to do so: products/services are divided into different categories based on profit impact and supply risk of the product/service and therefore a supply strategy for the different categories is possible.

Profit impact increase if the following aspects increase:

- cost on the total spending (↑)
- volume on total volume (↑)
- total cost
- total volume
- impact on quality (value of final product)
- impact on revenue generation

Risk depends on the following aspects:

- number of suppliers
- market structure (monopoly / free market)
- capacity suppliers can reserve us
- relation situation
- geographical distance
- logistics complexity



After each product is located in a category, different strategies can be adopted.



One challenge is the layer-supplier relationships the company has to manage, and 'roll' the risks related to these relationships. From the text it is clear how significant for the company is to know what is happening at the supplier end of their supply chain, therefore the problem here looks more to be within the second or third tier level of the suppliers, not with the direct first tier suppliers. It looks like the available information about the suppliers is scarce, that coordination, communication and trust are low. We do not have precise information, but we only know that the company operates in Europe, but we can reasonably assume that suppliers are global, aspects that make control and respect of the rules even more harder, for geographical distance, different cultures and different laws and regulations.

As we know from media, huge problems for the company brand can arise if unsustainable practices in the supply chain are discovered (e.g. Volkswagen, BP, Tesco, etc.).

The positive aspect is that the company is already aware of the fact that its image and value also depends by all the other actors in its supply chain. The challenge here is how to guarantee high quality and value of the brand, avoiding that unsustainable procedures of suppliers may damage the company.

The other positive aspect is that Sackie Brown is aware of the fact that a triple bottom line is important when managing purchasing and a company in general, therefore she knows how her decisions may contribute to create value or damage the brand image.

Some help may come from different tools, such as:

- codes of conduct
- supplier assessment
- supplier auditing

Codes of conduct can be stipulated together with the suppliers (depending on their number, but usually directly only with first tier suppliers → not good idea) and established determined rules and behaviours that the supplier has to follow to continue doing business with the company. In particular, hearing Sackie Brown knowledge about sustainable procedures, she may push to implement codes of conduct regarding:

- plants: in particular regarding the use and reputation of land to cultivate products that will be used to produce the final products of the company; the use of sustainable way of transportation to minimize the carbon footprint; the treatment of animals and the conditions in which they are bred

- people: in particular the conditions of workers, their working hours, their salaries and life conditions; do not damage local communities to create new spaces to grow plants or breed animals

Also, can be agreed that the quality of the products bought from suppliers follow certain pre-established specifications and specifications, exchanged between the companies or internationally recognized (eg. ISO). Since quality seems to be the main concern, this may be the most important aspect the purchasing department should focus on with these agreements.

Supplier assessment may be useful when selecting suppliers and evaluating them, since it is a starting point by which supplier can be enumerated through surveys of auto-evaluation (eg. the one we saw used by Matria to evaluate its suppliers).

It is important to notice that this is only part of the job to do, because opportunistic behaviours may be used by suppliers, therefore it is important to monitor them.

Here come in help supplier audits. These audits may regard different aspects to evaluate, such as:

- product
- process
- system

All of them are here useful:

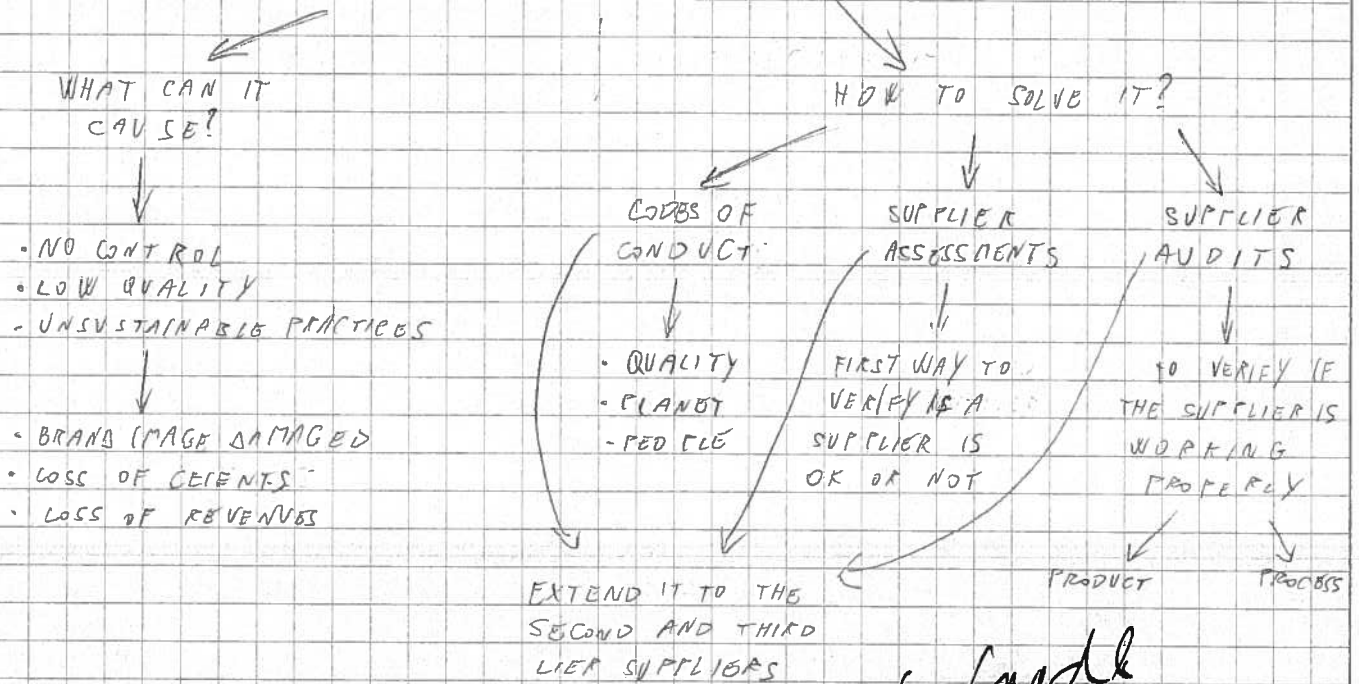
- product audits may be used to periodically evaluate the products bought from suppliers, verifying if they respect the recorded standards and, in case of negative results, take actions to repair the problem (and in case of repetitive negative results change supplier).

Process audits may be used to periodically evaluate the process suppliers - are using to obtain the product brought by the company. Here great attention and effort has to be paid, because it often the process by which a product is obtained (especially true for food) that can generate unsustainable procedures and in the end scandals.

It is also fundamental, since problems occur at the end of the supplier side, that those code of conducts, supplier assessments and audits are not only conduct and put into practice with first tier suppliers, but also with second and even third tier suppliers. It is sound more easier to say than to apply. A solution may be to have agreement with first tier suppliers, based also on great trust, so that they impose the same agreements to their suppliers, and the latter have to do the same with their ones.

It is therefore fundamental that trust, built through transparency and competence, upon communication and integration are built in the relationships to assure that the best results are reached.

CHALLENGE: KNOWING WHAT IS HAPPENING AT THE SUPPLIER END OF THE CHAIN



V. Gröndahl

The concept "transaction cost" includes all costs that are related to making a transaction between two parties. It includes all costs of contacting, contracting and controlling that occur from the transaction.

Looking at transaction costs is useful for purchasing professionals since it helps them better understand the full cost of a transaction, for example when comparing two suppliers. Instead of just looking at the purchase price, all other related costs are considered. However, it can in many cases be hard to identify all the related costs, since the cost of contact, contract and control can be spread in the organization. Moreover, they can be hard to quantify, since it includes a lot of "soft" costs like costs occurring from communication problems.

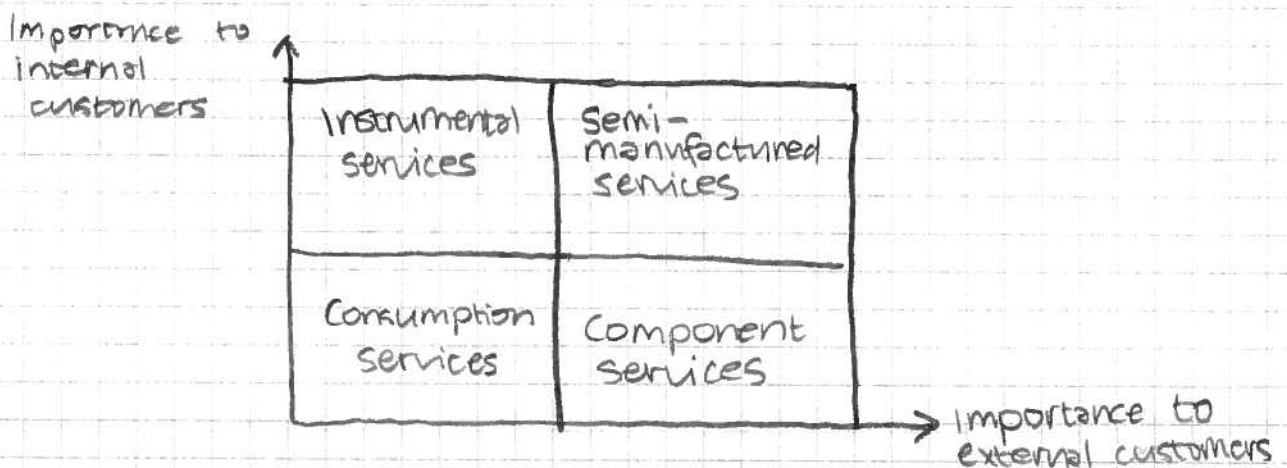
Therefore transaction costs in many cases turn out to be much higher than you thought they would be. This is usually the case when outsourcing to low-cost countries, where the price tag or labor costs are lower, but transaction costs usually increase.

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a) Buying services is important since it stands for an increasing share of a company's total spend. With companies focusing more and more on their core businesses, other activities and functions are to an increasing extent being outsourced. For example, facilities management is outsourced to service providers, as well as some companies outsource their entire HR-functions, or similar. Also, companies are to an increasing extent moving over their business model from selling products to selling services. This is happening for instance in the IT-business, where IT systems are offered as services instead of being sold as products. Hence, ERP-systems, which is a crucial purchase for a company, has turned into a purchase of service. Services affect a lot of people, both internal customers and in many cases external customers (when the service is part of the company's value proposition to its customers). Therefore it is very important to professionalize these purchases. However, a lot of companies don't understand that buying services and buying goods is different, and that services must be treated differently.

b) Since services are very different, classifying them can help the purchasing department to professionalize the buying of services. Classification of services help identifying which services that are crucial to spend effort on. It also helps allocating personell for different purchasing tasks. Moreover it helps identifying how the total purchasing spend is used, and what services that are more costly or bought in a higher volume.

Services can be classified in a lot of ways, since they are so diverse. One way is to classify them by type, like "what sort of service category" they belong to. Another is to classify them according to how much they cost. However, one good way of classifying them is by how important they are for the internal customers versus the external customers, as seen below:



For a company like ECTO, where the purchased service of transport is pretty much their entire

value proposition, it is crucial to separate between what is simply a consumption service that serves operations, or what is actually the services that they provide to their customers. Without classifying services, ECTO will most likely suffer from bad customer satisfaction as well as low purchasing effectiveness & efficiency, due to focusing on the wrong things.

c) Services are different compared to goods since they are intangible, heterogeneous, can't be stored, are created, distributed and consumed at the same time and hard to demonstrate or specify.

For specification, it means that this is not easy to do. A service is not of physical nature, and since you can't "touch" it, it is hard to write a specification of how it should be. For example the quality of a service is a lot about how the person receiving the service perceives it, which can be different depending on what actors that are involved. However, there are 4 ways of specifying services and depending on which one is being used it can have different effects on the "performance" of the service.

- Input specification - you specify what the service provider should use for inputs, but you don't know what you get in the end
- Throughput specification - you specify how the service is performed, you don't say what to use or what to get in the end
- Output - you specify what output you want to have when the service, not how to get it or by what means
- Outcome - you specify what the economic outcome of the output should bring

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For selection, this means that it is very hard to compare two service providers of the same service and make a rational decision. *

For contracting, this means that its is hard to write a good contract for services that assure you get what you want. Here it is important to consider if the contract should be behaviour based or performance based.

*Also for selection, dependching on how the specification was done, this has different impact on the selection criteria

Productivity relates to how efficient a company uses its resources, in terms of costs. Innovativity relates to how a company uses its resources to find new ways of acting or finding smart solutions and coming up with new ideas. In terms of supplier relationships, it relates to whether the actors, activities and resources of the relations are used to be innovative or productive through the relation.

There are four resource interfaces of supplier relationships: Standardized, specified, translational and interactive. Depending on what of these 4 interfaces is present between a supplier & customer, their productivity and innovativity is affected.

Standardized - neither the supplier or the customer adapts to each other. Both sides are rather standardized, which is productive since no resources are spent on adaptations. However, it brings no innovativity, since no new ideas are spawned when "every body looks the same."

Specified - the supplier side adapts to the customer side. The customer specifies what he wants so the supplier has to put resources in making some changes. This could be innovative, if the customer does not push the specification too far and leaving the supplier powerless to do it they way the

could do best. This means that with too much specification there is no innovativity. And regarding productivity - the more adoptions, the higher costs.

Translational - the customer makes adoptions to the supplier. In this case, the customer might not get exactly what they want, but the supplier is free to do their job in their best way possible which leads to innovativity. However, adoptions at the customer leads to some higher costs and a little reduced productivity.

Interactive - here the both parties adopt to each other, hence the customer and supplier work together in a closer relationship to find the best solution. This is very innovative since through the adoptions new ideas are spawned. However, this is costly - and even if productivity could be affected positively by new ideas & solutions, it is here sacrificed since adoptions are costly.

a) Involvement in buyer-supplier relationships.

Involvement in supplier-buyer relationship relates to how much effort the purchasing department spends on a relationship with a supplier, in terms of adaptations, how frequent contact is made, how long-term the relationship is and how dependent the buyer becomes on the supplier.

Spending too much effort on a relationship or being too dependent on a single supplier might be damaging for the company. However, too little involvement might mean higher costs of purchase, receiving too little service and prioritization from the supplier. Thus, a purchasing professional should find the right level of involvement for a certain relationship with a supplier.

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b) Straight rebuy.

A straight rebuy is the situation when you purchase a product that you have bought before, from the same supplier as before. This means that the purchase involves little uncertainty, both regarding the product and the supplier. For a purchasing professional, this hence means that less effort needs to be spent on that certain purchase. Instead of going through the whole purchasing process, only the last three are necessary (order, expediting, evaluating) since some sort of arrangement is already discussed with the supplier.

However, if the last purchase of this product from that supplier was evaluated badly (e.g. bad quality), or if this product has been bought as a straight rebuy for a long time, it might be worth considering if there are better alternatives available, meaning that all stages could be gone through anyway. Even if a straight rebuy should receive less scrutiny from the purchasing professional, it is important to not neglect them.

c) Hybrid purchasing structure.

A hybrid purchasing structure is a combination of a decentralized and centralized purchasing structure.

A hybrid structure is in fact a very common structure among companies, indicating that it is

useful to purchasing professionals. Actually, a hybrid structure is a good way of combining the benefits of the decentralized and centralized structure. The centralized structure comes with a more standardized purchasing department with concentrated knowledge, common routine, common approach towards suppliers and economies of scale from the possibility of reducing the supplier base and arrange for better deals. The decentralized structure is however more flexible and less hierarcic, with a possibility of the purchasers to be closer to the local suppliers and make use of local knowledge.

While a decentralized structure could lead to internal communication problems, a centralized one could lead to external communication problems.

A hybrid structure allows the purchasing professionals to combine the benefits, by for instance having a centralized purchasing department as well as a few local purchasing offices at each unit.

(d) Purchasing research refers to internal assessment of the purchasing department. This aims to find out the number of suppliers used, what is being bought and in what quantity, how the purchasing budget is spent, how the suppliers are handled etc. All to find out the efficiency and effectiveness

of the purchasing department's performance.

Supply market research is about external factors that the purchasing department can't affect, but have to deal with. This includes number of suppliers available, the amount of supply on the market, the number of buyers on the market etc.

The supply market research can be divided in several levels (macro, meso, micro) depending on what scope is suitable.

Both these concepts are useful to a purchasing professional, to identify what they can affect and what they can't affect but have to cope with in order to improve the purchasing department's performance. It is both important to improve the internal factors and adapt strategically to the external ones in order to be successful as a purchasing department.

e) Portfolio analysis.

A portfolio analysis could be done for products as well as for suppliers in order to achieve a good combination of them, control over the purchasing and differentiate between how to handle them.

Some products/suppliers might need more effort from the purchasing department than others, focusing on all is too expensive and focusing

2

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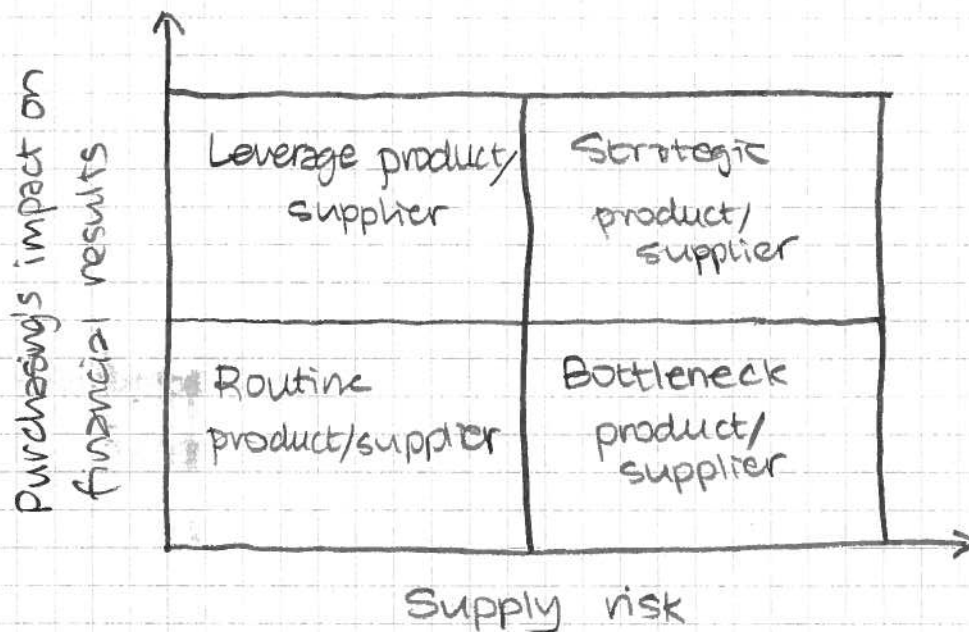
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on the wrong could have a devastating impact on the purchasing performance. Hence it is useful for a purchasing professional to make a portfolio analysis in order to focus on the right things in a structured way. One example is the Kraljic matrix:



This sort of portfolio analysis help categorizing the total spend of the purchasing department, and help them differentiate between four different strategies for how to handle the suppliers.

One of the key managerial challenge that Jackie is facing is first of all that she is in an entirely different context than what she's experienced in. A lot of the occurring challenges that lies before her organization can be traced back to the industry they operate in - food aimed to consumers. Jackie comes from a background where the market has few suppliers with high power against its customers. Now she's in a context where "Finest Food & Taste" has to deal with a lot of customers, that are all consumers of the product. In food industry, there are many players and products are in some extent commodities. All actors are hence competing for the same customers, which are usually quite price sensitive. Even if "Finest Food & Taste" has differentiated its products with high quality, there are a lot of other competitors in the food industry that does the same, so price is still an important factor.

The competitiveness and the price focus of the customers lead to big managerial challenges for Jackie's company when it comes to handling suppliers. As we know, pushing suppliers too hard can have devastating consequences, which we learned from the "horsemeat scandal". However, to stay competitive and win the customers, prices must be pushed to the limit within the food industry. What is tricky is that customers want low prices, high product availability,

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high quality and no unsustainable activities occurring from that what so ever. E.g. customers don't tolerate environmental impact that is too high, or socially unsustainable conditions for people involved in the supply chain. If it would be discovered that these things occur in the supply chain, the brand will be damaged for a long time and sales lost. Therefore it is of crucial importance that Jackie's company develops a strategy for how to handle their supplier end of the supply chain! The purchasing department play an important role here. Key factors that are important to consider are adverse selection, moral hazard, corporate social responsibility and environmentally sustainable supply management.

A company of the food industry usually have a lot of suppliers to choose from in most cases, leaving the suppliers with little power. Companies like "Finest Food & Taste" will probably use competitive bidding to achieve a low price when selecting suppliers. This could not only be bad in terms of TCO, it could also lead to suppliers withholding some information when tendering, in order to win the bid. This is known as "adverse selection". This could lead to choosing a supplier that is not capable of delivering what was agreed upon, or doing so by means that

are not sustainable. This is closely related to "moral hazard", when the supplier acts opportunistic to fulfill his own good, even if it might not be the best for the customer. If "Finest Food & Taste" push their suppliers too hard, the suppliers (or 2-tier suppliers) might start to "cheat" a little to save themselves. An example is that a farmer might start to use bad pesticides to secure his own sales of a big harvest. However, of course he will not tell his first-tier customer about this. Another example is that a supplier might use child labor, but when "Finest Food & Taste" makes an inspection they will of course not let this show. All of these types of problems will eventually come up to the surface. It is not only bad for the company, it is bad for all its stakeholders as well if these actions occur!

Writing a contract with every supplier is obviously not enough, and this is where codes-of-conduct as well as supplier assessment and auditing could prove useful. Codes of conduct are written "rules" of how every person within the organization should act in situations where sustainability or ethical issues arise. By writing them down, everybody has the same goals to follow. But writing them is not enough, they must be taught to every single person of the organization as well

as passing them on to the suppliers. However as stated before, suppliers might do anything to win a deal, so by having suppliers signing codes of conducts is not enough either. The buying company must assess that the supplier has capabilities of following through with the codes, as well as audit that they do. This is something Jackie's company must do.

To answer Jackie's request, there is no generic process of getting around these problems, since it is very much depending on the context. However, for Jackie's context, it might be good to start out by defining a code-of-conduct. Then it has to be outspoken to everyone - both internally and externally. Once it is clear where the company stands in its beliefs, they can start to let their suppliers do a self-assessment, as well as assessing them externally and then compare the results. Out of these results, action can be taken to improve environmental and ethical aspects. However, none of this can be done without having management on-board. To succeed with sustainable supply management, it is crucial that management is convinced of its importance. However the above discussion would be enough to convince them of the importance in this case.

Also, since "Finest Foods & Taste" probably has a lot of suppliers, many located in other parts of the world than where they operate themselves, it might be hard (and foremost expensive) to work with all suppliers in the same way. Therefore, a portfolio approach might be useful, preferably a Kraljic matrix where the axis of "supply risk" includes all risks concerning supply - also risks related to sustainability as discussed above. By identifying riskier suppliers, resources of assessment and audit can be distributed efficiently.

One other important factor when working with these suppliers is what contracts that are concluded. As said before, contracts are not enough, but they can be helpful if written correctly. To avoid adverse selection and moral hazards, behavior based contracts should be combined with performance based contracts to make sure that the supplier does the right thing, but also provides the right output.

(For key points, see next page)

Key Points

- Context of food industry
 - Competitive
 - Price Focus
 - Pushing suppliers
 - Key managerial challenges
 - Adverse selection
 - Moral hazard
 - CSR and environmental issues
- } → will affect sales!
- Establish a way of working with suppliers
 - Management must be engaged
 - Code of conduct
 - Self assessment and audits
 - Contracts combining behavior and performance
 - Classify suppliers by a portfolio approach
to focus on the right things

Exceeds
Price of
wage.

1. The key components of transaction cost are

- Contracting. This relates to all costs that occur when searching for suppliers and selecting suppliers.
- Contracting. Costs related to the contracting phase can be when a contract is negotiated, designed, agreed and signed.
- Control. Even after the contract is signed a lot of transactional costs can occur, it takes time and effort to monitor and enforce suppliers to make sure that they perform as agreed.

It is really useful for purchasers to be aware of these costs so that they take these into account when making decisions. For example it is important to have a TCO approach that includes all transactional costs, instead of just comparing suppliers on what purchasing price they offer. It is also extremely important to be aware of transactional costs when taking a make-or-buy decision. Because even though there can be suppliers being able to for example produce components at a lower cost—the costs for contracting, contracting and controlling can be significant.

To be aware of the transaction costs is also important for purchasers so that they can establish sustainable relationships with their suppliers. For example: when purchasing routine products, the transaction costs are often higher than the price of the products. Being aware of these, purchasers can redesign the purchasing process and for example use e-procurement solutions for this case (routine product).

Transaction costs are therefore tightly connected to what kind of relationship there are between the buyer and supplier (competitive bidding, arms length or if it is strategic partnerships),

It is also tightly connected to the size of the supplier base. So from a transaction cost point of view, it is beneficial for purchasers to reduce the supplier base.

This must of course be weighed towards the importance of the product, eg. product categorization, and the supply risk.

2.a) Buying services are a really important part for the purchasing department to professionalize. Often, companies spend a lot of money on buying services, but the purchasers are seldom involved. In some cases they are involved in just the contracting part. Through professionalizing the purchasing of services there can be many benefits in terms of for example cost savings, and improved performance of the supplier.

Maybe it is possible to reduce the supplierbase, consolidate and get volume discounts, reduce transactional costs and so on. Often there are not so much data collected and analyzed regarding how much, and from whom, services are purchased.

Buying services have become increasingly important for companies that have outsourced a lot of functions. For them, the services are a major part of their final value offer to their customers. To get the right performance is therefore critical, and also to secure long-term and ^{if necessary} close collaboration.

b)

2b) There are many different ways to classify services and each company must select one way that suits them best.

The classification is important since that can help companies to make a difference between different kinds of services so that they know how to approach suppliers in a specific category.

One way to classify services is the following:

1. Consumption services. These kind of services is delivered to the buyers customers. It affects the customer satisfaction immediately and is a great part of the value offer to the customers. For ECTO, the contracting with other transport providers (owning vehicles) can fall into this category, since these providers will be a great part of the value offer to the customers of ECTO. The performance of these providers will affect the customer satisfaction a lot.

2. Semi-manufactured services. The difference between this category and the consumption category is that these kind of services is just one part of the value offer. There are a lot more effort needed to provide a complete solution to the customers of ECTO. One example can be if ECTO has a contract with a company that rent us trucks and another one that rent us drivers. Both of these providers provide semi-manufactured services, and it is not complete until ECTO has connected them in their value offer to customers.

3. Instrumental services. These kind of services affects internal procedures and processes more than the actual value offer to customers. For ECTO this could be if they have consultants hired to improve some of their processes.

4. Consumption services. These services are often "consumed" internally too. It can be cleaning, maintenance and similar. For example cleaning the office at ECTO.

Another way to categorize services is for example if it is related to marketing, to HR, to R&D and so on. And Krajlics purchasing portfolio can also be used, and there are many more ways to do.

No matter what classification a company choose, the choice must provide a possibility to know how to develop good sourcing strategies in that particular category. Is performance partnership the best solution or should the transaction costs be as low as possible?

Purchasers at ECTO must really go through what types of services they are purchasing, categorize them, and then develop sourcing strategies within each category.

c) There are many aspects that make services differ from goods. Some differences are that services are intangible, can not be stored or transported and production, distribution and consumption is one and the same process. The ownership can not be transferred in the same way as for products and it is also harder to decide/know when the service is actually delivered. Also, it is not possible to demonstrate a service and so on.

This has a huge impact on the specification, selection and contracting stages. One major difference (compared to buying products) is that the internal users generally are much more involved in these processes.

One of the reasons is that it is hard to specify services. Usually the internal users hesitate that services can not be specified since the performance of the supplier, the trust and relationship with them, are aspects that can't be objectively stated. This makes it hard for purchasers to contribute in the selection and contracting phase, since internal users often already have decided which supplier they prefer.

It is also hard to compare suppliers, since it is not possible to get a demonstration. The service can also depend on what person, within the suppliers company, that perform the service.

For the contracting part, SLA is often preferred for services. This ensures, to a higher degree, that the expected

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Service level is reached. In the SLA it is critical to agree on KPI's and to make sure that both parties are agreed upon when the service has been delivered. For services it is often preferred to use an output or outcome based contract, because of the fact that the suppliers are often better at choosing resources and process to use. But still there are a choice between input-, throughput-, output- and outcome based contract.

3. A supplier relationship can be efficient in two different ways. We have efficient productivity, where the relationship leads to an efficient way of taking care of existing resources. The procedures and processes that the buyer and the supplier uses are efficiently performed.

Then we have the efficient innovativity where the current resources (in terms of personnel, management, information systems and policies and procedures) are combined in an entirely new efficient manner. The relationship is innovative and evolve over time.

Innovativity can be connected to, most of all, the interactive interface where the supplier are well aware of the buyers context and therefore can be creative and innovative. The actors interact, collaborate and communicate with each other to serve the demand of the end-customer both now and in the future.

They are often collaborating when doing research and development so that they can use their resources efficient and create innovative solutions.

The translational interface is somewhat similar, but the major difference is that the supplier often are not aware (to full extent) of the buyers context. This might limit the innovativity, even if there are room for some degree of it. Since the buyer only specifies the needed functionality and similar, the supplier can use its expertise and knowledge to combine its resources in the best way which probably will lead to a innovative, but of course to some degree also a productive, solution.

The specified and the standardized interfaces are not that interactive or "open" which makes it really hard for the relationship to generate innovative efficiency.

But there are on the other hand a greater opportunity to be productive and resource efficient. This is especially the case for the standardized interface, where no adaptations are made to each others context. There will be economies of scale and an opportunity for productive solutions.

When using a specified interface towards the supplier, the supplier might be able to adopt their processes and products somewhat to fulfill the buyers needs.

But there will still be room to consolidate similar orders and benefit from economies of scale eg. be productivity efficient.

To summarize:

Resource interface	Efficiency
Interactive	Innovativity
Translational	Mostly innovativity, some degree of productivity
Specified	- ← productivity, - → innovativity
Standardized	Productivity

4.a) The involvement in buyer-supplier relationships relate to the degree of interaction and collaboration between the parties. For example it is common for companies to involve suppliers (that are of strategic importance) early in the development phase of new products to gain from their knowledge base. This will also lower the development costs and gives a possibility to share risk and gain. One example of when it is beneficial to involve suppliers early in the development phase is if they can propose changes in the product or process design. It is much less costly to do the changes early in the process than later on. This is a greater opportunity for purchasers to, except from providing a big knowledge base for innovative solutions, build long-term relationships with suppliers. The direct involvement will also strengthen the trust between the parties, which is of great importance in a long-term relationship of strategic importance. Purchasers must consider the dependency and lock situation that arises from this kind of involvement though.

b) A straight rebuy is when exactly the same product is purchased from the same supplier as last time. For purchasers, this will shorten the original purchasing process where: a specification is formulated, supplier are selected, a contract is agreed and signed, and then the purchasers order, expedite and evaluate. When doing a straight rebuy purchasers often can start with just ordering, depending on the terms and time period of the contract.

The important thing here, for purchasers, are to review the contract on a periodic basis to make sure that the

contract is competitive. To continuously do market research and evaluate if there are new promising suppliers are important to ensure that we have a good deal. This must be weighed against the transaction costs that arises from these kind of activities though (contracting and contacting new suppliers).

One way to make the transaction costs really low is to use e-procurement solutions. This is especially suitable for straight rebuys if the product is standardized and has a low financial impact.

c) A hybrid purchasing structure is a combination between a decentralized and centralized approach. For example we suggested a category sourcing strategy. That was a combination between a decentralized and centralized approach for LF. For companies like LF this is a good structure when there can be benefits to consolidate the purchasing of commodities (that several business unit uses) to reduce supplier base, transaction cost and increase the bargaining power. The bargaining power can be a reason itself for using a more centralized approach, and also so that the business units don't compete for the same capacity and so that

they don't end up at different prices. But a completely centralized approach is not always the best solution, since the business units may have specific knowledge regarding the production or requirement that are more efficient and effective managed on a decentralized level. The contact with suppliers are also becoming more direct which is beneficial, both for LF and for other companies in the same situation. It is really common that companies design their own hybrid structure that works best for them, given their specific strategy, market situation, geographic spread, business area and so on.

d) A supply market research can be done on three different levels; Macro, meso, micro.

On the macro level (country level) research regarding political development, employment in a country, development of labour cost and so on must be considered.

On meso level research is concentrated to a specific industrial sector. Important factors are supply market structure (monopoly, oligopoly, monopolistic competition or pure competition), resource scarcity, switching costs, substitutes, legal and government rules, taxes and tariffs etc.

At micro level a specific company is analysed, that includes financial data, capacity, flexibility as examples.

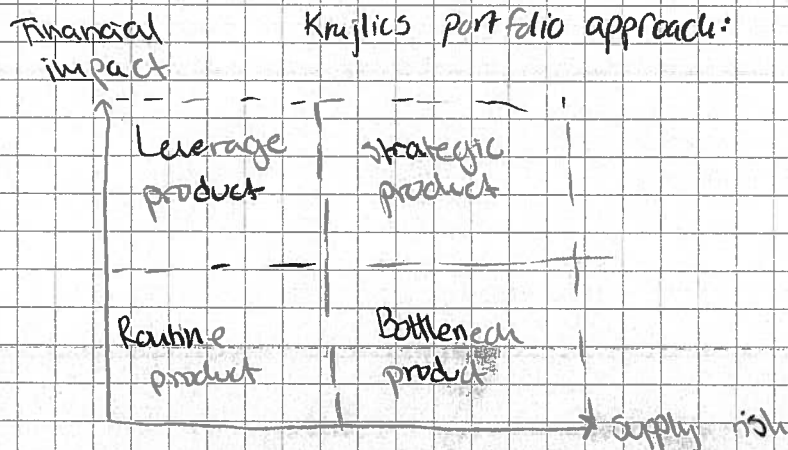
When doing purchasing research, it is very helpful to work on these three levels. Starting with risks and possibilities on a macro level can guide the decision about what country to source from, dealing with the challenges of global sourcing.

In addition to the factors mentioned in the macro research level, cultural differences (ways of doing business, language barriers etc.) must also be taken into consideration.

Moving on to meso level, the current and future situation in the specific industry can be mapped which also highlights potential supply risk aspects.

Finally, purchasers can analyze on supplier-level when being aware of the external factors. Maybe some external risks can be mitigated through a proper contract and relationship with the supplier.

e) A portfolio analysis can provide a good categorization of products, guiding purchasers when developing relationships with supplier(s) for a product in a specific category



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As seen in the picture, products are categorized depending on the financial impact and the supply risk.

A product that has a large impact on the final cost price, a product that stands for a large part of the total volume of the final product or where there are much room for cost savings (negotiation, volume discount) are high up on the financial axis.

Supply risk determines on a lot of different risk aspects, the major one are: market structure, switching costs, available substitutes, numbers of suppliers, long- and short term availability, financial position, capacity utilization, our volume of their total volume, political issues, taxes and tariffs and so on.

Routine products are therefore available at a really low supply risk and stands for a small part of the final cost price.

Here, the handling and transaction costs should be minimized, which guides purchasers to a low involvement relationship with a few (or one) supplier. Good to use e-procurement.

Leverage products are also of low supply risk, but here are the products much more of financial interest. A small change in price will generate a huge total saving. This leads to the fact that purchasers should have a competitive bidding strategy to secure a fair price.

Bottlenecks are fairly similar to routine products but the huge difference are that the supply risk is high. Maybe there are not a few suppliers available, which leads to a completely

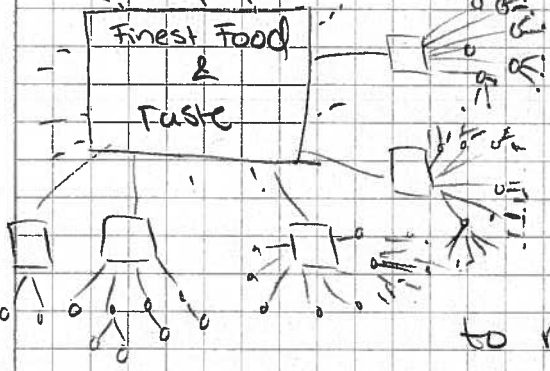
different purchasing approach. Purchasers needs to secure supply and continuously search for substitutes.

For strategic products, that are really important, purchasers should strive for a performance based relationship. Collaboration and interaction is of great interest here.

The portfolio approach also help purchasers to identify the power balance. For routine- and strategic products the balance is often good. For routine, no involvement is of interest and for strategic products co-development is good to make the relationship better. For leverage products the buyer has the power and should therefore try to co-design in order to get financial benefits. For bottleneck product, the suppliers has the power instead and through co-design the power balance could be more even. Purchasers should therefore try to involve suppliers in the design.

Important to notice is that the supplier and buyer should have a common view on this categorization to really benefit from the relationship. Therefore it is good if purchasers takes this discussion with their suppliers to make sure that they have an aligned view and similar expectations on the relationship.

5. Since you are in the food industry, for a leading retail company, I believe that you have a large supply base only looking at the first tiers. But looking further down, the supply base are most probably really huge and dispersed, on a global level



This means that it is hard to control all suppliers in the supply chain at the same time as it is necessary and really critical to make sure that your company is not highlighted in media, hurting your brand badly.

There are several challenges connected to this situation that you are in right now. First of all, global sourcing is a major challenge. Your company is dealing with suppliers operating in very different environments where the culture and distance is between you and your suppliers.

Another challenge is that your customers are very sensitive for price (for most products at least) which definitely can be a problem. If you squeeze your suppliers too much, demanding them to lower their price, they will probably push that requirement on to their suppliers. This can lead to a worse quality, in order to lower the costs. There are many examples of this, as you mentioned: the horsemeat scandal for example. You should be aware of moral hazard and adverse selection which are problems related to this.

Moral Hazard is a typical example of what's mentioned above, the supplier changes for example the quality without informing

their customers, or they inform the customers but the customers doesn't have to knowledge to stop it. The key point here is that suppliers can take increased risk, to survive on the market, which increases your risk even more even though you are not aware of it.

Adverse selection is instead when a supplier is not telling the truth or just saying exactly what you are asking for and nothing less. You should be aware of this because it might happen that they are hiding things that increases your risk profile a lot.

It is really challenging to avoid moral hazard and adverse selection since they are tightly connected to trust, which are not developed fast, and the Agency problem. Since it is related to the agency problem you can do your best to make sure that your goals are aligned, that you trust them to not behave in an opportunistic manner, and that they are having incentives for performing good.

To align both your own company and the whole supply chain to work in a sustainable is a challenge since First of all, make sure to add sustainability to your cornerstones! You need an aligned strategy and common goals. It should be obvious and clear internally and externally that you stress sustainable actions. There should be an objective way of measuring performance and it should be possible to compare the performance over time. To develop good KPI's can be tricky. Most important is that everyone is agreed upon these KPI's and that they are included in a contract. The KPI's should cover the effectiveness, efficiency and the sustainability.

So, to summarize, your key challenges are

- Global sourcing with a dispersed supply base
- To be able to trust your suppliers
 - to give you the right, and all, information
 - to provide the requested quality
 - to follow your sustainable approach
 - to not behave opportunistic
- To align the supply chain towards better sustainable performance through agreed KPI's. Starting applying it in your own company, with support from top management.

I would say that the contracting part is really important for you combined with developing a codes of conduct (the template you mentioned).

In the contract, be really detailed, and involve key subsuppliers in the negotiations so that back-to-back contracting is used to establish relationships with key lower tier suppliers are essential too. They can provide good market information.

A service level agreement is to prefer, with clearly stated expected performance and connected KPI's. Here, you have the possibility to specify extra logistics requirements for your growing segment of fresh products, and other important aspects for certain product categories.

When designing codes of conduct for your company, it is really important that it is on a detailed and specific level, guiding decisions for employees at your company and at suppliers in the supply chain. It should be designed for your particular context, and not

on a general level. Of course it is good to base it on the recommended codes of conducts in Europe, but redesign it where you find it necessary. To include requirements on ISO standards for environment, quality and social responsibility is to recommend.

You can also state that suppliers should be certified by fair trade and similar to avoid some degree of risk and transfer some degree of responsibility to confirm the suppliers performance to external parties.

In the code of conduct you can specify what ethical rules, what behaviour and what requirements you demand from suppliers in your supply chain. The problem is of course to make sure that they actually comply with the requirements. Supplier assessment might not be good enough, referring back to the discussion about moral hazard and adverse selection. Audits will be necessary, on a regular basis, to make sure that conditions haven't changed.

Since quality is one of your cornerstones you should develop a quality assurance process. It is recommended that

you visit the supplier and develop improvement strategies together to improve weak areas in their "production" process. Let them provide sample products, so that you can confirm the quality before approving them. This can also be a part of the qualification process to

be a qualified supplier, following your code of conduct. Also, since product development is a cornerstone, involve selected suppliers in an early phase, since they have knowledge you can benefit from, giving innovative solutions.

To summarize, there are a set of key challenges to deal with in your particular situation and context. These are summarized earlier in the text. In addition to these, the following subjects are of high importance to deal with in the near future:

- Align goals and strategy both internally and externally in the whole supply chain
- Develop KPI's that support the strategy
- Develop a company specific codes of conduct, that can be used to qualify suppliers
 - supplier assessment and audits (on a regular basis) necessary
 - Quality assurance

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- Contracting
 - Service level agreements
 - Back-to-back agreements
- Establish relationship with ^{some key} lower tier suppliers to be updated about changes in the market and monitor their performance extra carefully. Also include them early in the product development phase, if they are key suppliers that can provide value.