PURCHASING EFFICIENCY IMPACT ON INVENTORY VALUATION AND COMPANY'S PERFORMANCE

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Abstract:

Inventory constitutes a significant asset on the balance sheet of trading & manufacturing companies. Purchasing strategy and function affect the level of inventory and business performance of company to great extent. Effectively measuring and managing inventory is essential for keeping companies financial statements up to date and presenting true & fair view of financial statement. This paper established that the purchasing function contributes to level of inventory, cost of product and thereby on business performance. This Article links business and inventory performance to purchasing efficiency.

Keywords: Inventory, performance, purchasing, business

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Introduction:

Inventory is a major determinant of net income for trading & manufacturing companies. Inventory constitutes a significant asset on the balance sheet of trading & manufacturing companies. An accurate valuation of inventory is important because inventory will affect the cost of goods sold, gross profit, and net income on the income statement. It will also affect the amount of current assets, working capital, total assets, and stockholders' or owner's equity reported on the balance sheet. Inventory valuation and management is very important for managing current assets on the balance sheet. Monitoring & measuring of inventories is an important aspect of inventory valuation. If monitoring and measuring inventories is not given proper consideration accurate and reliable decisions are difficult to make. Suppliers are the key element in the success of lean manufacturing commonly known as Japanese production systems. Lean manufacturing was primarily dependent on supply management. It served as a initial triggers of purchasing as a strategic weapon. Aligning purchasing function or strategy and capabilities with the overall business strategy is important; it links the competitive potential of purchasing to the implementation of practices, such as supply base rationalization, supplier evaluation, or information exchange. Purchasing strategy is an intermediate element between business strategy and purchasing capabilities.

In this Article section A contains Related Work and section B deals with framework for Purchasing competence & efficiency and conclusion.

Section A

Related Work

Wells J.T. et al. have mentioned that valuation of inventory includes two elements; Price and quantity [1].Tyson R. Browning et al. have said that implementation of lean practices will reduce waste and thereby decrease costs. Novelty, complexity, instability, and buffering affect the relationship between lean implementation and production costs [2]. Matthias Holweg et al. have reviewed that the lean concept is the outcome of a dynamic learning process. It is based on the practices adopted by automotive and textile sectors in Japan [3]. Watts et al. have mentioned that supplier is the key pillar in understanding the success of Japanese production systems popularly known as Lean manufacturing. Lean manufacturing is mainly dependent on supply management. It emphasizes greatly on purchasing [4].Womack et al. have mentioned that to improve firms performance Japanese production system relies on a set of practices including Kanban, total quality management, Just in time practices [5]. Fullerton et al. have said that JIT has included a broader set of production and purchasing practices [6]. Hahn et al. have mentioned that just-in-time purchasing (JITP) involves supplier management and receiving frequent deliveries of small quantities of materials with consistent quality from suppliers [7]. Claycomb et al. have state that JIT integrates the entire supply chains marketing, distribution, customer service, purchasing and production functions into one controlled process. JIT is a comprehensive strategy that combines the primary tactical element of JIT- Production and JIT- Purchasing [8]. Schonberger et al. have argued that JIT purchasing characteristics focus on using a small number of suppliers with whom the company maintains long-term relationships, having frequent deliveries in small quantities, ensuring supplier quality performance, and controlling the shipping process [9]. Skinner et al. pointed out the relevance of linking manufacturing strategy and policy with business strategy, so that the manufacturing strategy's efficiency supports the business strategy [10]. Vickery et al. argues that production competence represents the contribution of the production function to the implementation of business strategy, and therefore, for this function to be strategically relevant, a positive relationship between production competence and business performance must exist [11]. Narasimhan et al. have said that ability of the purchasing function to support business strategy depends on either the implementation of certain concrete purchasing practices or the extent to which purchasing practices are aligned with the overall business strategy [12]. Carr et al. have said that for strategic purchasing to exist, corporate and functional strategies must be consistent [13].

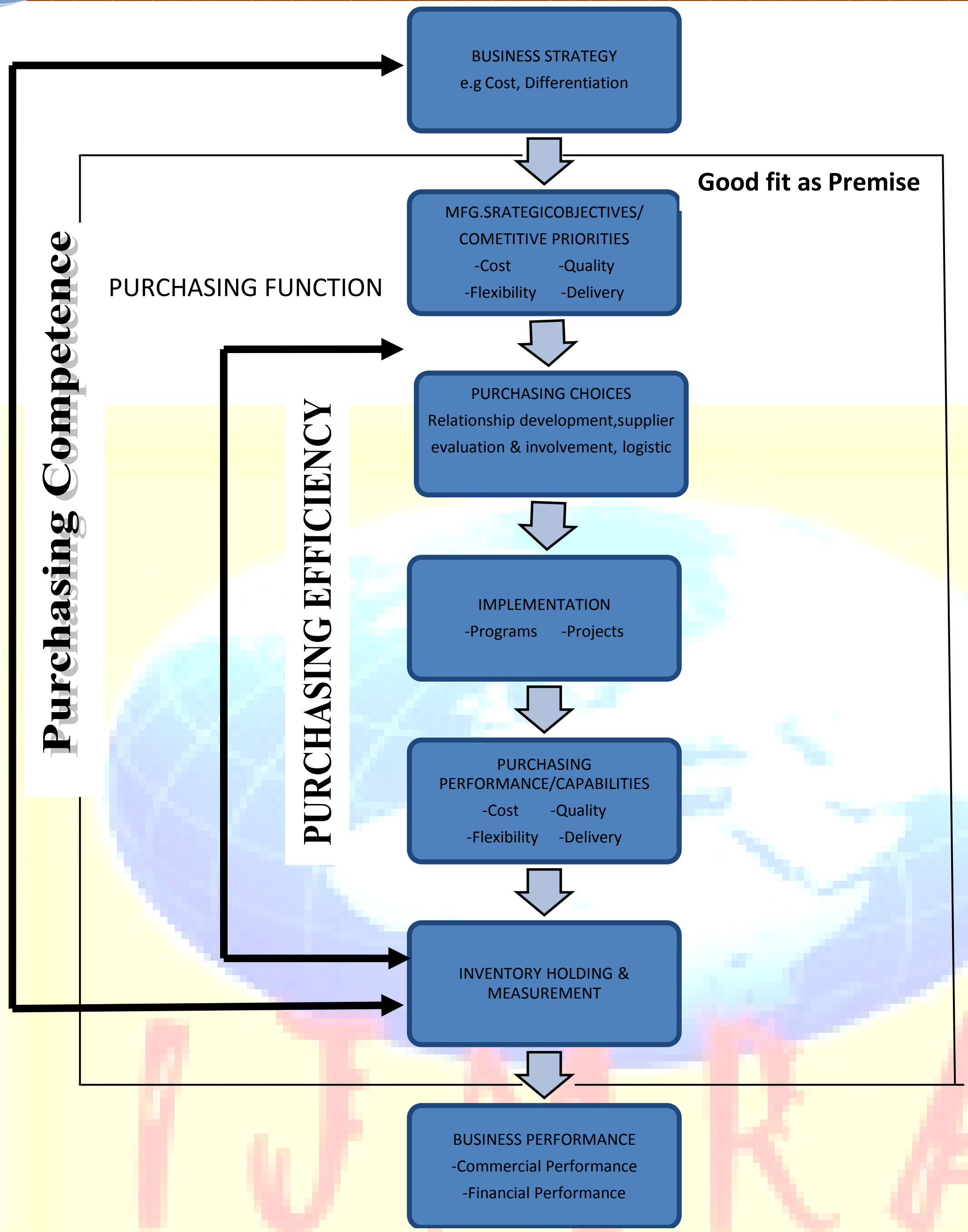
Section B

Framework for Purchasing competence & efficiency

Integration of purchasing strategy with the overall business strategy is important, it links the competitive potential of purchasing to the implementation of a set of concrete practices, such as supply base rationalization, supplier evaluation, or information exchange. Role of purchasing capabilities is also very important because the ultimate purpose of any purchasing practice is to achieve certain capabilities, and these capabilities must be aligned with business strategy. Purchasing contribution to Inventory and business performance depends, on the degree to which purchasing capabilities fit with the business strategy and how well it will support the business strategy. Purchasing strategy is an intermediate element between business strategy and purchasing capabilities. In other words purchasing contribution can be subdivided in to two parts. First is purchasing efficacy which can be defined as integration between purchasing strategic objectives and business capabilities which represents the capability of the purchasing function to realize its functional objectives. Second is integration between purchasing strategic objectives and business strategy, which is an immediate consequence of the strategic integration of purchasing.

1. **Purchasing efficacy** Purchasing efficacy means the capacity of the human and technological resources of the purchasing function to achieve the projected objectives.
2. **Purchasing Strategic Integration** Purchasing Strategic Integration refers to integration of the purchasing strategy with the overall business strategy and Inventory strategy. Effect of certain purchasing practices on performance is greater when the strategic integration of purchasing is stronger. This relationship occurs because specific practices get implemented deliberately to support the business strategy.

Purchasing functions that are able to meet their projected objectives and able to achieve good performance in those aspects the firm considers important, contribute significantly to overall business and inventory performance. Purchasing capabilities and their alignment with business and Inventory strategy must be taken into account to explain the contribution of purchasing to Inventory and business performance. Top managers must consider that to extract greater competitive advantage from purchasing, they should combine two lines of action. On the one hand, they should attempt to integrate the purchasing function into the strategic planning process of the overall business to ensure that its functional objectives align with the business strategy. To achieve this kind of integration, different initiatives should be promoted: purchasing managers should be invited to participate in the strategic planning process; business strategy should be properly communicated to the purchasing professionals; training and incentive schemes in the purchasing function should be oriented to the achievement of the overall business objectives, and purchasing should be encouraged to formalize its own long-term plan to develop and support business strategy. Organizational structure may be changed to indirectly promoting these initiatives. Same organizational status must be given to purchasing function as to other functional areas such as manufacturing or marketing so as to facilitate the strategic integration of purchasing. Top managers should provide the purchasing function with necessary human and technical resources to achieve its projected objectives. The establishment of training and development programs for purchasing personnel and an appropriate recognition of the purchasing function within the organizational structure are also necessary. Alignment of purchasing capabilities with business strategy is important to improve performance. Instead of replicating those practices that have been beneficial in other companies, managers should strive to assess the capabilities that are fit in with business and purchasing competitive priorities. The same practices are not equally good for any company because the capabilities they generate are not equally necessary at any company. In this sense, managers should think in terms of purchasing capabilities required by the company and look for those practices able to provide such capabilities in the most efficient way.



Conclusion

The purchasing function contributes to Inventory Holding, Inventory valuation and thereby business performance. This contribution depends on the interaction of two elements: purchasing efficacy, defined as the alignment between purchasing strategy and capabilities, and purchasing strategic integration, which indicates how well the purchasing strategy and business strategy are integrated for advancement of business.

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