

SOURCING APPRAISAL AND

EVALUATION IN IMPORT PROCUREMENT

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Import Procurement. Textbook on how to select and evaluate suppliers, in Purchasing for import - discusses factors to consider in selecting sources of supply, methods of procurement; developing a supplier profile, sources of information; stages in selecting suppliers, and specific methods and techniques for their evaluation.

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## I. INTRODUCTION

In import procurement the one activity which in a sense underlies the realization of all other objectives of a good purchase decision is the selection of the supplier. Even when an importer may have done his homework in identifying the "right product" to meet his needs, the achievement of the importer's objective will ultimately depend on how well his selection of the supplier has been. The importer must ensure that the supplier is able to provide goods which conform to the buyers standards and specifications. If the supplier ultimately ships goods which do not meet the buyer's requirements all his other objectives will also not be realized. Likewise, if the supplier fails to ship the goods on the agreed date, his objective of having them at the "right time", will not be achieved. Delayed delivery would also mean that the objective of the "right price" would not be realized, as the delay may mean stockout and replenishment at a much higher cost. The same would be true of short delivery.

Thus, the importance of selecting a dependable and a reliable supplier is self-evident and this holds true irrespective of the economic status of the importer's country. It is in this context that supplier assessment and evaluation has received very great attention in procurement management in developed countries. In contrast, in many developing countries supplier evaluation, both at the pre- and post- contract stages, has received less than the required attention for several reasons.

One reason has to do with the colonial hang over which has affected a large number of developing countries. During the colonial period, import trade was handled by a few dominant companies from the metropolitan country. Often the importing company was an outpost of a home trading and/or manufacturing company. These trading links continued even after independence. To some extent this is attributable to an adjustment process as new links are established. However, in most cases this can also be attributed to the institutional changes resulting from policies of partial or total nationalization of foreign trade, particularly imports. Lack of expertise and experience of public procurement agencies and state trading organizations meant continuation of the past links under new arrangements.

On the other hand, the involvement of the public sector has meant a requirement or a marked preference for one particular method or procedure for procurement, namely, that of global tendering. The assumption or belief that a global tendering system not only ensures a competitive price but also a reliable and a dependable supplier meant that a separate assessment and evaluation of a supplier was not by itself important and called for. However, changes taking place in the developing countries and in the rest of the world have altered the import management scene to such an extent that neglecting a proper supplier appraisal and evaluation can be costly.

The process of economic development in developing countries has vastly increased the volume and variety of import needs, as a result of an increase in the standards of nutrition and consumption. On the one hand, demand for traditional imports has gone up. At the same time, demand for new and an entirely unfamiliar range of products has emerged. Accent on health care programmes and immunization campaigns has led to increased demand for both general and specialized drugs and medicines. In particular, a conscious effort in the diversification of the economic structure has vastly changed the dimension and composition of the import profile of most developing countries. The overall effect of all these developments has meant a vastly increased dependence of developing countries on foreign, and often, distant sources of supplies for a wide variety of imported products - consumer goods, raw materials, spare parts, components, technical services, technology, process know-how, capital goods, transport equipment and the like.

Along with these developments in the demand for imports, the importer in

a developing country has had to cope up with the changes that are taking place on the supply side. The last three or so decades has seen a surge of new suppliers, competing effectively with established ones, that have developed new technologies, processes and products with the ability to meet given demands more economically and/or having a better technical or aesthetic appeal.

Thus, the import procurement task has become more complex and need for sourcing of reliable and dependable suppliers more important than ever before. The search for an acceptable supplier can be greatly assisted by adopting a systematic approach to supplier appraisal and evaluation. This Practical Guide is intended to provide a survey of the different considerations of relevance to supplier sourcing and selection.

II. IMPORT PROCUREMENT OBJECTIVES AND SOURCE SELECTION

A. The "right" source as an objective

A generally accepted view on the overall objectives of the procurement function is that the importer should obtain the "right" product in the "right" quantity for the "right" delivery time and place, from the "right" source and at the "right" price. It should be noted that literature advisedly uses the word "right" instead of such others as "best", "earliest", "lowest", etc., in recognition of the fact that it is illogical to expect that a buyer will be able to reconcile all these conflicting objectives except through tradeoffs. For example, if a buyer wants superior quality than is the accepted market grade for the product, he will not be able to get it at the prevailing market price. He will be quoted a higher price, the difference accounting for the premium for quality. Similarly, if the buyer is in urgent need of supplies, implying a short delivery time, particularly when the market for the product is tight, he will again be quoted a higher price than for the normal or customary delivery time. In general, therefore, the buyer will always have to reconcile these different objectives taking into account his constraints and priorities within the prevailing international market situation for the product in question.

In this context, it is apparent that having the "right source" is only one among these other objectives. However, it needs to be appreciated that selecting the "right" supply source is, in a sense, a key decision area in as much as the achievement to the desired extent, of the other objectives, critically depends on the supplier fulfilling his contractual obligations fully. How well the supplier has performed will be known only after a lapse of time, usually towards the close of the contract period. If it is then found that the supplier has shipped goods which do not conform to the buyer's specifications, it is obvious that the latter's objective of "right quality" would not be met. Similarly, if the supplier ships the goods much before or much after the due delivery date, the buyer's objective of having the goods at the "right time" will not be achieved. In consequence, his objective of the "right price" will also not be achieved. In the first case, replacement of below standard goods will mean additional delays and disruption of downstream activities and hence increased costs. Likewise, replenishment of stocks due to delay in deliveries (or short shipment) will mean additional cost. Supplies in excess of the "right quantity" will mean additional inventory holding costs. In either case, it will imply that the buyer is not able to achieve his objective of the "right price".

It is true that purchase contracts do make provision for penalties for deviations from or default on contract terms and conditions. However, these rarely, if ever, compensate the buyer for all the damages that he may have to sustain.

Firstly, a bona-fide buyer goes through the arduous and expensive task of floating a purchase enquiry, of evaluating offers and finalizing the purchase

contract only because he is in need of the goods of a particular quality by a particular time to meet a specific purpose. The compensation which he may eventually receive from the supplier for default on quality or delivery does not meet his primary purpose of acquiring the intended product.

Secondly, the process of settlement of disputes in international commerce is notoriously time consuming and expensive, Moreover, the buyer can never be certain that the decision will necessarily be in his favour, given the complications which often surface in regard to the applicable law and other similar issues. Lastly, it should be noted that the indemnity for default rarely , if ever, compensates the buyer for losses which, while not directly attributable to the default in question, may be incidental to it. In this context, in theory, a buyer can also protect himself against such costs incidental to a supplier default by insisting on incorporation of a very high value for liquidated damages in the contract. However, should the supplier agree to such a proposition by the buyer, he would likely wish to insure his own risk by insisting on a higher price. Secondly, in the event of a dispute, it is possible that the court may restrict the compensation to what it considers as adequate, unless the contract is unambiguous on this clause.

#### B. Major factors in source selection

If, then, the buyer is to achieve his procurement objectives as fully as possible, what are the attributes of a good supplier that he should look for? A simple answer is that, apart from being able to offer a competitive price, such a supplier should be dependable and reliable. In terms of the buyer's procurement objectives, this would mean that the supplier should be able to ensure conformance to the buyer's desired quality standards and delivery schedule. He should be in a position to provide pre- and after-sales service, if so required, and generally, extend his cooperation in ensuring contract fulfilment.

Before discussing the attributes of a reliable and dependable supplier, it is important to note that in ensuring supplier conformance, particularly in regard to the quality of the product, the buyer has an important responsibility. Firstly, the buyer must make sure that he is himself clear about the product that he wants. Secondly, he should communicate these requirements to potential suppliers as precisely as possible. <sup>1/</sup> To avoid any ambiguity, and later disputes, he should specify the product characteristics in terms of one of the following:

- Physical, chemical, metallurgical specifications and acceptable tolerances;
- National standards (buyer's own country)
- Other country's standards
- International standards (e.g., International Organization for Standardization);
- Market grades;
- Industry standards;
- Manufacturer's own standard
- Brand name;\*
- Manufacturing process specifications;
- Drawings (engineering);
- Samples:
- Performance specifications;
- Acceptance tests;

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<sup>1/</sup> See also ITC Practical Guide on Import Management No. 7 Import Specifications and Supply Conformance For Industrial Products, p. 13.

\* To reduce the restrictive nature of this term, it is necessary to add the words "or equivalent" to the brand name at the offer invitation stage.

Once the buyer has layed down what he wants, as clearly and in as much detail as is necessary for effectively communicating with a potential supplier the latter's ability to conform to some or all of the contract terms and conditions will depend on his:

- Technical ability;
- Manufacturing facilities;
- Financial strength;
- Managerial competence.

However, the relative importance of these suppliers' attributes will depend on the product in question. For some standardized products, acceptable tolerances around the basic specifications allow for some deviations and, at the same time, manufacturing process. The required technical ability for efficient production is, therefore, relatively less demanding and with an easier availability of the required skills. It is also possible that the size range for efficient scale of production is also wide, so that the required manufacturing facilities show a good deal of variation.

A large number of such products are marketed and distributed not by the manufacturers but by traders. In such a situation, the supplier is not required to have any manufacturing facilities of his own. However, it should be borne in mind that a distributor is, in a sense, a proxy for the manufacturer and that his strength, and in particular his weakness, could be a direct reflection of the principal(s) whom he represents. It is thus important that, when placing a big order for purchasing a manufactured product, the buyer as a rule should ask the supplier to identify the principal(s) whose products he intends to supply, and, by way of proof, should be asked to produce a letter of accreditation to that effect. This part of the supplier evaluation process will be relevant to first time potential suppliers of a given product.

For non-standardized manufactures, complex machinery, plant and equipment, evaluating a supplier capability with reference to the four attributes mentioned earlier can rarely, if ever, be avoided.

1. Technical ability

Of the four attributes of a reliable and dependable supplier, the one relating to his technical ability is important in a crucial sense for a number of products, as has been mentioned above. This is so since the reliability of such products, and their performance in use or operations, will crucially depend on the supplier's technical competence or capability. Quality defects will upset all downstream activities of an importer. Moreover, the quality defects will often be latent and will show only after the product has been put into use. In addition, the technical capability of a supplier of machinery and capital goods reflects itself not only on the productivity of the product but also on its durability, maintenance requirements, repairs, replacements and serviceable life. <sup>2/</sup> At the same time, the assessment of technical competence

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<sup>2/</sup> See ITC Practical Guide on Import Management No. 9 Bid Evaluation in Import Procurement, pp. 26-30.

of a supplier is not easy to make. It has been reported, for example, that the results of "quality capability surveys" are often statistically questionable. <sup>3/</sup>

A guide to a supplier's technical competence can be obtained from an appraisal of the standard of his in-process quality control, and/or at the output stage. For a large number of products, good pre-despatch quality

control techniques and procedures will go a long way to ensure a zero rejection rate after delivery. The benefits to the buyer, for example, of a "Zero Defects Programme" at the supplier's end are:

- A low (or zero) rejection rate after the goods have been delivered, hence lower costs connected with the repair or disposal of defectives, claims processing and the like;
- Lower inventory holdings and the associated costs;
- Savings in time and costs of inspection on receipt of goods.

In fact, the increasingly popular "Just in Time" inventory management system is feasible for a buyer only if his supplier has a successfully operating "Zero Defects Programme".

## 2. Manufacturing capability

The adequacy of the manufacturing facilities of a potential supplier as a criterion of assessing his reliability is obvious. Only if the supplier has an adequate manufacturing capacity, in relation to a buyer's order quantity, will he be able to meet his quantity and delivery commitments. However, this will not by itself be enough to ensure compliance with these requirements. Besides adequacy of capacity, it is also important that the plant is in good operating condition. Old and worn out machinery will often mean too frequent breakdowns, more shut down and plant maintenance time. Moreover, the more modern the plant the greater is the assurance of uniformity in quality and product reliability.

## 3. Financial strength

The financial strength of a supplier is of crucial importance from the point of view of judging a supplier's ability to meet his contractual commitments to the buyer. Lack of financial resources, at the very least, impairs a supplier's ability to meet a buyer's quantity requirements and or his delivery schedule because of his inability to finance a large inventory of in-process and/or warehouse stocks. Nor would a financially weak supplier be in a position to secure to required raw material supplies, particularly if the market for some of these is getting tight and advance action on purchasing raw materials is the only way to ensure adequate and timely supply. This aspect of the reliability and dependability of the supplier is particularly important in so far as high valued contracts are concerned, where the fabrication and manufacturing period for the product may be lengthy. Such a supplier would also be in a better position to provide supplier credit, even for a limited period, than another with a weak financial position.

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3/ See Olive R.W., "The Quality Capability Survey: A Procurement Quality Management Control", Journal of Purchasing, February 1969, as referred to in Purchasing and Materials Management by Leenders, Michiel. R., Fearson, Harold E., and England. Wilbur B., Richard D. Irwin, Homewood, Illinois 60430, USA, p. 136.

## 4. Managerial competence

The role of management as a vital input to a successful and profitable business is well recognized. While the most tangible index of efficient management of a business is the record of its long-term growth and profitability, good management practices show themselves in management plans, organization of management, corporate structures and plans, management controls, management of industrial relations, rapport with suppliers and clients, etc. It is also self-evident that quality of management is particularly important for a supplier of high value, high technology products including machinery, plant and equipment.

While, the importer should seek the "right source" taking into account



the above factors, in practice many importing organizations in developing countries tend to be somewhat passive in their sourcing for, among others, two main reasons. One reason has to do with the procurement methods more commonly used, particularly the predominant use of global tendering. The second has to do with the cost which proper sourcing involves and the generally held view that the cost of supplier sourcing and evaluation will not be commensurate with benefits in procurement of most products.

C. Procurement methods and supplier sourcing

The procurement methods commonly used in import procurement in developing countries, <sup>4/</sup> particularly by public procurement organizations, are the following:

- Global tendering;
- Limited (or restricted) tendering;
- Negotiated purchasing;
- Long-term contracting.

1. Global tendering

The chief merit claimed in favour of the method of global tendering in import procurement is that it gives equal opportunity to every supplier to make an offer within the terms and conditions of purchase set by the buyer, and thereby promotes competition. In addition, this method also eliminates the scope for favouritism, by virtue of the associated procedures. In public procurement, global tendering is particularly recommended for this reason as a safeguard against a public procurement officer/manager compromising public interest in favour of his own personal gain.

In terms of the set of procurement objectives referred to earlier, it is obvious that by using this method "price" tends to get the highest weightage, since the decision criterion for supplier selection is the "lowest price", other things remaining the same. These other things are mostly the terms and conditions that the buyer lays down in the invitation to tender. In general, it would be fair to say that supplier reliability and dependability get little or no weightage in the evaluation of offers. The buyer's terms and conditions of purchase do usually provide for the buyer's right to reject any or all offers. There is also usually a provision for a supplier bid bond and a performance bond. As far as the first of these is concerned, experience shows that it is often difficult to reject an offer if the prospective supplier's

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<sup>4/</sup> For merits and demerits of different methods, see Raina, Hari K., Guide to Import Management, Programme for Development Cooperation at the Helsinki School of Economics, Helsinki, Finland, 1987, pp 56-59  
price is the lowest and he has fulfilled the conditions of the invitation to tender. Likewise, in the event of the importer taking action towards forfeiture of either of these bonds, the prospective supplier invariably raises a dispute. As has been mentioned earlier, settling os such disputes in international commerce is expensive and time consuming.

In general, it is reasonable for the buyer to risk avoiding an elaborate supplier evaluation process when buying standardized products through global tendering. In case of repetitive purchases of the same product a record of past performance can be a good guide in source selection. The rules and procedures of the system of global tendering of the procurement agency may not permit precluding an offer being made by a new potential supplier. In such a situation an evaluation will be required for the new supplier(s) using external sources of information. However, when buying non-standardized products like machinery, plant and equipment, the risk of ignoring supplier evaluation will be enormous. In fact, while retaining some of its essential features, the system of global tendering will itself require to be modified, as is often the practice, to limit competition to a selected number of

potential suppliers.

## 2. Limited tendering

This method of import procurement is a variant of the one described above. In the method of global tendering, the invitation to tender is open to any supplier willing to make an offer. The usual requirement under global tendering is that the invitation be given wide publicity through a Government Gazette, local newspapers (though sometimes through selected foreign newspapers as well) and by display on the notice board of the buying organization usually reserved for the purpose. As against this, in restricted tendering the invitation to bid is mailed to a selected number of suppliers, chosen through purposive supply market research. Ostensibly, this method gives weight to supplier reliability and dependability. However, in actual practice this weightage depends on the extensiveness and the depth of supplier market research that may have gone into preparing the list of eligible invitees. <sup>5/</sup>

## 3. Negotiated purchases

The method of negotiated purchase is generally used for products of a proprietary nature where there is only one supplier of a product. In this case the question of relative evaluation of suppliers does not arise. However, this procurement method has also come to be used (often in combination with the method of global or limited tendering) by some importing organizations, which work in a more flexible purchasing framework than is customary for public procurement. The importing organization, for example, first issues a global or a limited tender enquiry, and then negotiates the price with those suppliers which have made the most advantageous offers. In this later hybrid application, the extent of weightage which supplier evaluation receives depends on the specific method of supplier sourcing and evaluation that is adopted. If, for example, a non-discriminating global tendering method is adopted, the weightage is almost negligible, if any, unless negotiations on price, and/or on other terms and conditions of purchase are preceded by investigations aimed at evaluating the relative credentials of different potential suppliers.

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<sup>5/</sup> See Chapter III of this Guide describing the different ways in which seller profiles may be compiled.

## 4. Long-term contracting

This method of procurement is one in which supplier evaluation should and does receive a very high weight. The main motivation for an importing organization to enter into a long-term contract generally is to ensure supplies over a long period of time so that he does not have to bother about changes in the supply market conditions. In general, long term contracting is useful for raw materials for industry or agriculture. No buyer would (or, for that matter, should, enter into a long term contract for such inputs unless he is sure of the prospective supplier's reliability. Thus in this case, an extensive and an in depth evaluation of a supplier's, long term financial, managerial, technical and, above all, production capabilities and perspectives can be ignored only at very great risk to the buyer.

### D. Product characteristics and supplier evaluation

Apart from the method of procurement which an importer uses or is obliged to follow, the nature of the product has an important bearing on supplier sourcing, evaluation and selection. In general, the more complex a product in terms of embodied technology more important it is to ensure that the right supplier is selected. There are two main reasons for this. Firstly, purchase of technologically complex products usually means a significant outlay of money. The risk associated with non-conformance of goods to buyers' performance specifications is, therefore, very high. Secondly, there is the possibility of latent defects which will show only some time after the product

has been put to its intended use. In the meantime, a buyer normally would have incurred other expenses towards buying other associated products or equipment and/or setting up the required facilities. The overall risk of supplier failure for this type of product is thus a multiple of that associated only with the non-conformance of the product itself.

The supply market for primary products and/or semi-processed or processed industrial inputs is, with exceptions, more competitive partly because product characteristics and specifications are well established and acceptable tolerances well defined. In addition, the manufacturing processes have been technically perfected over long periods and enjoy a fair degree of universality in application.

As against this, manufactured products are a mix of standardized non-durable consumer goods, semi-processed industrial inputs, durable consumer goods, industrial manufactures used in a wide variety of industrial or non-industrial economic activities (e.g., traction equipment, tractors, fork lifts, conveyor systems, commercial vehicles, etc.) and non-standardized machinery plant and equipment, each for a different purpose. There is a sort of regression in the degree of market perfection as one goes along the mix of products in this group. The market structures generally see a progressive concentration and reduced degree of competition as one advances to more complex product lines. The source selection, therefore, assumes added significance for this reason as well as for those referred to earlier.

III. SUPPLIER SOURCING

A. Developing a profile of suppliers

Supplier selection is a multi-stage process. The first stage is the identification of all the potential sources which would seem to be in a position to supply the required product. It should be noted that the only procurement method in which this stage is of somewhat limited (or even no) significance is that of global tendering. In all other methods of procurement this stage has to be completed before other stages in supplier selection can be taken up.

1. Survey of potential suppliers

This stage consists of developing a preliminary supplier profile or list of each and every potential supplier. It is possible to divide the approach to the preparation of this list into three components, according to the method and/or the sources of information that the importer uses. These are (i) the internal records survey; (ii) the intentions survey; and (iii) supplier identification survey.

(a) Internal records survey

An importer who has been importing a product in the past should be able to develop a profile of potential suppliers from his own records of past purchases. All that it requires is that the importer maintains his records properly. However, there is one disadvantage in relying entirely on records of past purchases for developing such a profile. The approach limits the scope of examination and selection only to those who have supplied the product in the past. If it so happens that in the past only a few suppliers had made offers (and of course only one would have been selected for any one purchase contract) the list of suppliers figuring in the purchase records of the buyer would be extremely limited. Directing enquiries only to those on such a list would not ensure competition and may not result in the best possible buying decision.

It is, therefore, a good purchase strategy to use internal records to

develop a supplier profile but to supplement these with information on potential suppliers from external sources as well.

(b) Intentions survey

There is a large number of external sources of information which a prospective importer of a product can use to develop a fairly exhaustive profile of potential suppliers. These will be reviewed later in this chapter. One such source is the supplier himself, and importer should make every effort to elicit the interest of prospective suppliers to register or enrol as possible sources of supply. It is usual to enrol prospective suppliers through one of the following two ways.

- Without pre-qualification requirements
- Through pre-qualification evaluation.

(i) Without prequalification

An importer may, through a general advertisement, invite all prospective suppliers to register filling a prescribed form developed by the importer for the purpose. The form asks for the name, address and telex, telephone number of the company and the name and designation of the person to whom any future purchase enquiries may be directed. It also asks for the product or range of products that a company may supply. The responses are then used to develop a more refined profile of prospective suppliers of a product using other external sources of information. All future purchase enquiries are then addressed to only those suppliers as are so registered with the importer.

The advantage of developing this refined list is that it limits the number of responses, as compared to a general invitation to submit offers through global tendering. It thus helps to reduce the work connected with the evaluation of offers. However, the system does not necessarily ensure that the supplier is in fact competent (i.e., that he has the necessary production facilities and the technical, financial and managerial capability) to deliver the right goods and at the right time. The method is thus not used in international procurement except for standardized products. Here also, it is not that popular a method since it has the disadvantage of restricting competition unless the profile of suppliers is updated regularly at the beginning of the procurement cycle.

(ii) With pre-qualification

The approach in this system is largely the same as in the previous one, except in regard to one important feature. Unlike the earlier method, the aim of a pre-qualification system is to ensure that only those suppliers that can prove through documentary and other evidence that they fulfil all the requirements prescribed by the importer may be registered as future suppliers. The application form for registration, naturally, is more detailed than that in which pre-qualification is not required. While the precise details of the registration form will differ from product to product, most will seek details on production capacity/facilities, management credentials, bank references, membership of industrial associations/chambers of commerce, etc. In addition, the importer may ask for a list of clients and projects executed by the supplier (in case of supply contracts involving plant and equipment). The importer may also seek the company's annual reports, besides any other published materials such as catalogues, samples or any other tangible evidence which would help establish the applicant as a dependable and reliable supplier.

In case of repetitive purchases, i.e., purchases of a product more than once in a procurement cycle, the importer may prepare a standing list of prospective suppliers with a validity of one year. In the meantime, he should update the preliminary list (see page 10) through supply market research and then refine the supplier profile using the pre-qualification procedure.

However, for special purpose plant and machinery, purchased infrequently as and when required, the preparation and the use of a standing list is not advisable, by the very nature of the procurement problem, as it does not serve any useful purpose. In general, the time gap between one purchase and the next is likely to be large. In the meantime, it is possible that new suppliers may have entered the market, and developed and introduced new technologies. It is also possible that the buyer's requirements and/or technical specifications of the product may change. For all these reasons, the buyer will each time have to go through the different stages of indentifying potential suppliers - prepare a preliminary list from diverse sources of information, (including his own records of past purchases), select those which prima facie appear to be competent, and send a questionnaire eliciting information and documentation as would establish their interest in being considered for inclusion in the list of potential suppliers as well as their competence and reliability. It is only when a supplier has cleared this phase of the evaluation process that he is included in the list of potential suppliers.

(c) Supplier identification survey

An importer can also use a large number of external sources of information to prepare a preliminary list of potential suppliers (see section B, below). The coverage of each source varies and it is advisable to use several to ensure that most suppliers, if not all, find a place in the list.

2. Pre-contract short listing

Whatever the method may be of preparing the preliminary list of potential suppliers, it may be further refined before purchase enquiries are made through further supply market research including checking references with industry associations, chambers of commerce, bankers, reputed business enquiry services etc. It is also possible to carry out this refinement of the list after the purchase enquiries have been sent to potential suppliers. However, as a rule, it is better to do so before sending out purchase enquiries for two main reasons. Should a particular supplier happen to submit a very competitive price bid, the buyer may be tempted and this may influence his objectivity in regard to the supplier's dependability and reliability. Alternatively, a supplier, if he is price competitive, but is ignored by the buyer on doubt in regard to his dependability and reliability, may claim that his position as the most competitive supplier is being ignored. Public procurement agencies are particularly sensitive to such complaints and insinuations by suppliers. To avoid later embarrassments it is better, therefore, to short-list suppliers before purchase enquiries are sent out.

3. Up-dating of supplier's profiles

As mentioned previously in the case of standardized products which are purchased repetitively at frequent intervals, it is a useful practice to have a standing list of suppliers to whom purchase enquiries may be sent whenever stocks are to be replenished. However, it is important that the list be updated from time to time. The list can be updated partly from the buying organization's own records of individual supplier performance in the past. Suppliers whose performance has been unsatisfactory in any way whatsoever should be deleted from the list. At the same time, new suppliers should be added after verification of their credentials.

B. Sources of information

There are many sources of information which an importing organization can and should use to develop a profile of potential suppliers. Likewise, there are many sources which the buyer should use to check or verify the dependability and reliability of each supplier. As mentioned earlier in this chapter, the sources can broadly be divided into two broad classes: the importer's own records of past purchases, and external sources.

1. Importer's record of past purchases

The use of records of past purchases and their limitations was referred to earlier. It will, therefore, suffice to add here that an importing organization can make use of this source only if such records are maintained properly. This requires a systematic post-contract audit and evaluation of each supplier's performance. Lists of suppliers with a good record of contract performance, categorized by products, will then be a useful source of information.

2. External sources of information on suppliers <sup>6/</sup>

The external sources of information on suppliers may be divided into the following categories:

- Published sources;
- Industry/commercial associations;
- Specialized commercial services;
- Commercial banks;
- Commercial representations of governments;
- Trade promotion organizations;
- Other sources.

Some of these sources can be further subdivided on the basis of the special characteristics of each source.

(a) Published sources

There is a large number of published sources of information on prospective suppliers. The following is a fairly exhaustive list, but not all - inclusive:

- General directories;
- Country-and product-specific directories;
- Commercial journals - including those which are industry specific.

General directories with a regional or international coverage are a useful source of information for the purpose of developing a preliminary list of potential suppliers. Country specific directories, however, tend to be more exhaustive in terms of coverage of suppliers although restricted to the country of reference. Product specific directories are usually even more exhaustive in coverage and generally include details on capacity (of manufacturer suppliers) and production, besides the name(s) of top management, telephone and telex numbers, etc. Often these directories include leading trading companies as well besides as manufacturers.

The number of general and specialized directories is far too great, and listing all of these here is not feasible. Some of the fairly exhaustive general country directories giving names, addresses and other details of suppliers are:

- Kompass Directories (for different countries particularly in Europe and South Asia))
- Thomas Register

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<sup>6/</sup> See ITC Practical Guide on Import Management No. 5 Information for Better Import Management, especially p. 51

- Bottin Enterprises (France - available in five languages including English)
- Wer Liefert Was (Federal Republic of Germany - available in five languages including English)

It may be mentioned that these are only illustrative and it is not the

intention to commend these to the exclusion of others.

Trade and commercial periodicals vary in coverage and periodicity. Some of these, particularly those which cover a given industrial sector (e.g., chemicals), may occasionally contain a review of an industry, whether global or country specific. Such reviews usually deal with general issues of demand and supply, as well as technological aspects concerning the industry being reviewed. Information on suppliers is usually in the form of advertisements. Trade journals covering more specific product areas (e.g., fertilizers) are even more valuable sources of information on suppliers. Apart from advertisements, such journals sometimes contain news items which can be relevant for assessing supplier capability - plant breakdowns, state of industrial relations, management reshuffles, financial situation, etc.

Published sources of information do not always suffice in either developing or refining a list of potential suppliers, particularly for purposes of establishing each supplier's capacity and reliability. Often other sources have to be tapped.

(b) Industry/commercial associations

Industry and/or commercial associations are a valuable source of information for purposes of assembling a list of potential suppliers. Such associations take different forms and their use is often complementary. Chambers of Commerce and one form of such associations. Most commercial and industrial establishments in a country are usually members of such chambers. Often a national chamber may be a confederation of regional (or state level) chambers in a country. A prospective buyer can always get, on request, a fair amount of useful information on suppliers from the national chamber of a particular country.

Similarly, most enterprises or industries in a country are usually members of an association - e.g., association of non-ferrous metal manufacturers, or electrical equipment manufacturers, etc. By contacting such an association it is usually possible to get names, addresses and other details of their members. As a rule, these associations also publish directories of their members with postal addresses, telex and telephone numbers, which are updated from time to time. These directories are a useful source for preparing a list of possible suppliers. However, the source will usually suffice only for non-sophisticated products and low value contracts. For high valued purchase contracts it will be necessary to have more specific information which will help the buyer in evaluating a supplier's credentials. For this purpose, other sources of information will have to be used.

(c) Specialized commercial services

There are a few well-known commercial services which specialize in maintaining, on a worldwide basis, information on well established manufacturers and other companies. Business investigation is their specialty. For a fee, a buyer can get a status report on technical, managerial, financial and any other aspects of a supplier's attributes, enabling an evaluation of the supplier's competence. The two well-known business investigating firms are:

- Dun and Bradstreet, USA;
- Moody's Investor Services, USA.

It should be mentioned that a reference to these agencies will normally be useful only before making a final supplier selection and prior to award of contract. For preparing the preliminary list of all potential suppliers and short listing of those included therein, it is generally advisable to use other less expensive sources of information. However, specialized commercial services may be used even at this stage when the contract value is large

and/or the product in question is technically complex.

(d) Commercial banks

Commercial banks are yet another useful source of information for supplier evaluation. However, to get information from banks on a supplier's financial status or credit rating may not be always easy. It may be necessary to obtain some sort of a no objection certificate from the supplier authorizing his bank to respond to a buyer's query. However, an indirect way of getting such information on a potential supplier is for the buyer to approach his own bank to ask its foreign branch or its customary correspondent bank in the supplier's country for help in this regard.

(e) Commercial representatives

Another source of information is the commercial representative of supplier's country in the buyer's country as well as the reverse. Part of the duties of a commercial representative is to promote his own country's exports in the country of his posting. He is, therefore, eager to supply commercial information to potential buyers on request. Since an unreliable supplier can bring discredit, and can in fact be an embarrassment to his endeavour to promote trade, he can be relied upon to usually provide names and addresses of reliable suppliers. Likewise, part of the duty of a commercial representative is to help his own country's trading community in doing business in the country of his accreditation. He will therefore, make reasonable effort to collect as much information on a potential supplier as he can and make it available to the buyer if so requested.

(f) Trade promotion organizations

Aggressive export trade promotion by governmental or quasi-governmental bodies is a feature of the present times. Export promotion councils, boards of trade, etc., have been set up by almost all countries to help exporters in finding markets and to provide assistance in various ways to help develop export trade. Sometimes these organizations are set up by industries and generally have information on their members. In fact, a firm's membership of such a body is usually a good indication that the firm is worthy of being included in the preliminary list of potential suppliers. As is the case with some other good sources of information, a positive reference from an export promotion body will usually suffice in establishing the business credentials of an exporting firm for a fairly large number of standard products. For non-standardized products, use of other sources of information would often be required in the short-listing process.

(g) Other sources

There are several other sources and methods of collecting information which an importing organization in a developing country can use to prepare a preliminary list of potential suppliers and/or to refine and update a vendor list. Some are expensive and should be used only when the purchase value is high and the technical complexities of the product are such that establishing the supplier's capability would be not only warranted but an essential step in supplier evaluation. Some of these other sources of information are:

- Field surveys
- Quality surveys
- Sales staff
- Other customers
- Catalogues

(i) Field surveys

An importing organization can gather first hand information on supplier capability by visiting manufacturing facilities of a selected number of



prospective suppliers. A purchasing team consisting of representatives from different departments of the organization can best assess the technical manufacturing, financial and managerial capability of a prospective supplier by visiting his corporate offices as well the manufacturing plant(s). However, since the exercise could be expensive, such a method of supplier assessment should naturally be used only for large value contracts and only after suppliers have been short listed using other sources of information.

(ii) Quality surveys

An important attribute of a reliable supplier is his ability to supply the product that will meet the buyer's requirement fully. This requires that the product should conform to the buyer's technical, design, material input and/or performance specifications. A supplier's quality control methods and system can have an important bearing on the ability of a supplier to meet the quality standards of a buyer. Often, a pre-contract assessment will be rewarding in selecting the "right" supplier.

(iii) Sales staff

Sales representatives of prospective suppliers are a good, and an inexpensive, source of information for identifying potential suppliers. This source can be used, along with others, in preparing a preliminary list of potential suppliers. Other sources and methods may then be used to refine the list.

(iv) Other customers

Yet another good source of information are the past and present clients of a prospective supplier. It is often useful, and may sometimes be necessary, to contact such clients to find out about their experiences in dealings with the supplier. Often, potential suppliers (of turnkey projects, major equipment, etc.) publish names (with addresses) of their clients in their brochures and other publicity material. An importer should try to tap this source discretely so as to assess the strength and the weaknesses of a supplier.

(v) Catalogues

Most manufacturers publish catalogues showing the products they manufacture and specifications to which they conform as part of their publicity and sales effort. A buyer can use this material to prepare a preliminary list of potential suppliers. For refining the list, other methods such as field and/or quality surveys, would be required depending on the value of the purchase contract.

#### IV. METHODS AND TECHNIQUES OF SUPPLIER APPRAISAL AND EVALUATION

##### A. Stages in supplier selection

The process of selection in import procurement can be looked at as involving four stages. These are (i) the survey stage, (ii) the inquiry stage, (iii) the selection stage and (iv) the experience stage. The first three stages come at the pre-contract phase of this process. These stages are involved with indentifying new suppliers. As against this, the last stage - namely, the experience stage, - comes only after the contract has been concluded and in due course supplier performance has been monitored and evaluated. The result provides feed-back for supplier selection for the next phase of the procurement cycle.

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 Survey
 

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 Pre-contract                      Inquiry
 

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 Selection
 

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 Post-contract                      Experience
 

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Of the three stages in the pre-contract phase, the first one is concerned with developing a preliminary list of all potential suppliers who, seemingly, would be in a position to supply the intended product of import. The inquiry stage is concerned with collecting information which enables an assessment of supplier ability and reliability. The selection stage uses the information collected during the first two stages of the process to refine and narrow down the list of potential suppliers to those to whom the purchase inquiry may be directed. It should be noted that selection stage here refers to evaluation for inclusion in the abridged or refined list of potential suppliers. In import procurement, selection of a particular supplier with whom the supply contract will eventually be concluded will result from evaluation of all offers received in response to a purchase enquiry, whether a global or a restricted tender.

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7/ See Heinritz, Stuart F. and Farrel, Paul V., Purchasing: Principles and Applications, Prentice Hall Inc. Englewood Cliffs, New Jersey, U.S.A., p. 221

8/ See ITC Practical Guide on Import Management No. 9 Bid Evaluation In Import Procurement

An import procurement organization should continuously identify new sources of supply, and update and enlarge the profile of potential suppliers. This is particularly necessary for those items which are procured on a repetitive basis from year to year and during the year, where a tendency may exist to automatically purchase from traditional sources of supply. However, this does not mean that existing suppliers are ignored. In fact, in their case evaluation of their suitability is easier to assess. Past performance can provide a very useful feedback for this purpose. However, it is necessary for the importing organization to set up an effective system to monitor the performance of its suppliers and maintain proper records of their performance in a form which assists in their evaluation.

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 B. Evaluation of new suppliers
 

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Identifying new sources of supplies should be a continuing task of an efficient importing organization, if it is to take advantage of the ever widening international competitive environment. This process of identification is, however, complete only when each supplier so identified is evaluated in regard to his reliability and dependability. The task of evaluating new potential sources differs from that of existing sources inasmuch as the buyer has no information of his own in regard to past performance of the former. Therefore, the techniques and methods of evaluation which are relevant to evaluating new potential sources may not have the same relevance as for existing sources. It should, however, be noted that the capabilities and efficiency of existing firms is not immune to change and, therefore, application of these evaluation techniques would still be warranted from time to time, to ensure their continued reliability and dependability as a source of supplies.

As mentioned in Chapter II, the four most common factors in evaluating potential suppliers are technical ability, adequacy of manufacturing facilities (or plant capacity), financial strength and managerial competence or capability. The importance of each of these factors, will differ very much depending on the nature and the complexity of the product to be purchased. Moreover, the cost of carrying out the evaluation of a supplier with respect to each of these characteristics or attributes can be prohibitive. An importing organization should therefore be selective and should weigh these costs vis-à-vis the risk associated with the probability of loss due to possible non-conformance. In general, the higher the value of a single purchase order and the greater the technical complexity of the product to be procured, the greater would be the justification for undertaking the evaluation exercise in great detail and depth.

## 1. Technical ability

### (a) Technology input

As noted earlier, the technical ability of a supplier implies his competence to supply goods of the quality specified by the buyer. Quality of a product depends to a large extent on the quality of the materials that are used in its manufacture. In technically complex products the quality of inputs becomes an integral part of overall reliability of a product. There is what may be called a technology input which, along with the materials input, determines a product's capabilities and reliability. This technology input is intangible and, hence, not amenable to normal quality testing methods and measures, as is the case with material inputs. In general, this quality attribute is manifested in the durability, productivity and the life span of the final product and is, hence ascertainable only during the course of its use. Before placing an order, it is necessary for the buyer to carry out a special technical capability survey to ascertain more directly the technical ability of the supplier to ensure the quality of the product in question.

### (b) Technical capability survey

To carry out a technical, including quality and capability survey of prospective suppliers, it may be necessary for the importing organization to constitute an internal expert group (with expert help from outside, if necessary). In general, such a group should include, besides purchasing staff, experts from the design, engineering, production and finance/accounts departments. Being an inter-disciplinary group, it will be able to also look at other aspects of supplier reliability and dependability (e.g. production facilities, financial strength). Through desk research, as much information as possible should be obtained on suppliers to provide necessary background for further investigations which may involve visits to the supplier's facilities. Often, in case of high valued complex plant and machinery, some of this preliminary information can also be obtained directly from the prospective suppliers through a survey form for this purpose.

A sample format for this is on page (21). It should be noted that this format may need to be modified suitably to meet the specific needs of a buyer. For example, in the format no information has been directly sought on the in-process and/or other quality control procedures, that the supplier may have instituted at his works. Should the buyer wish it, a provision in the format explicitly seeking such information should be made.

For carrying out such a survey effectively it is advisable to develop a reference list of points to be covered by each member of the team so as to facilitate grading and evaluation. The points which such formats should include will depend on the product to be imported. For some products it will be necessary to have separate detailed formats for engineering and purchasing.

As will be noted, the specimen format (page 21) also asks for the names

and addresses of recent customers. This should be done only if the buyer intends to contact some or all of these to seek their opinion on a supplier's reliability and dependability. The buyer has the option to visit these customers or to seek the information by mail. The former option can be expensive and in the latter the response could be uncertain and unreliable. The buyer will have to weigh the costs and the benefits of one approach against the other. However, should the buyer choose the latter option, he

9/ See ITC Practical Guide on Import Management No. 9 Bid Evaluation in Import Procurement, pp 26-30.

a/ For a specimen of one set of such formats being used by a company, see Peter Baily and David Farmer Purchasing Principles and Management, Pitman Books Ltd., London, IVth Edition, 1981, pps. 113-118.

SUPPLIER CAPABILITY SURVEY

COMPANY NAME \_\_\_\_\_

ADDRESS (CORPORATE OFFICE) \_\_\_\_\_

ADDRESS (PLANT(S)) \_\_\_\_\_

Persons to be contacted ----- Name ----- Title ----- Tel. No. -----

Corporate office  
plant

Year established: \_\_\_\_\_ Country of incorporation: \_\_\_\_\_

PRINCIPAL OFFICIALS \_\_\_\_\_ Title \_\_\_\_\_ Tel. No. \_\_\_\_\_

A. Corporate office

- 1.
- 2.
- 3.

PLANT

\* Please name key managers in the design, engineering and production and quality control departments

POSITION/POST

- 1.
- 2.
- 3.
- 4.

PRINCIPAL PRODUCTS MANUFACTURED \_\_\_\_\_ YEAR \_\_\_\_\_ CAPACITY \_\_\_\_\_ PRODUCTION \_\_\_\_\_

(use separate sheet for more products) \_\_\_\_\_ last 3 years last 3 years

1. \_\_\_\_\_  
1. \_\_\_\_\_  
2. \_\_\_\_\_  
3. \_\_\_\_\_

2. \_\_\_\_\_  
1. \_\_\_\_\_  
2. \_\_\_\_\_  
3. \_\_\_\_\_

3. \_\_\_\_\_  
1. \_\_\_\_\_  
2. \_\_\_\_\_  
3. \_\_\_\_\_

<u>RECENT CUSTOMER REFERENCES</u> <u>(names and addresses)</u>	<u>ITEMS PRODUCED AND SUPPLIED*</u>	<u>LATEST DATE</u>
---	-------------------------------------	--------------------

- \* 1.
- 2.
- 3.

<u>NAMES AND ADDRESSES OF CREDIT REFERENCES (banks/Suppliers)</u>
---

- 1.
- 2.
- 3.

Note: Please attach a copy of your latest company annual report, catalogues, brochures, etc.

would need to ask pertinent questions on quality, delivery and service in such a manner that it is not too cumbersome and time consuming for the respondent and at the same that the buyer can use the information to rate or rank the potential suppliers directly without the need for further refinement or processing.

A model enquiry for this purpose is given on pages 25 and 26.

It is possible that the buying organization may not be able to or willing to carry out a technical capability survey itself. It may be that the managers technically competent to carrying out such a survey are pre-occupied with some other important activities which could be affected by their absence. It is also possible that costs involved in carrying out such a survey (to cover all potential suppliers) may be too prohibitive to justify sending out an in-house team of experts. In this case, it would then be more prudent to seek outside expertise. In many countries, particularly in industrialized countries, professional services are available which carry out, for a fee, technical and quality capability survey, for the buyer. Most such services have either branches or associates in many countries of the world.

2. Manufacturing capability and services

(a) Production facilities

It is important for the supplier to have adequate manufacturing facilities in relation to the scale and size of the purchase contract which the buying organization is contemplating. If the potential supplier is to qualify as reliable and dependable, it is important not only to have an adequate plant capacity but also that the equipment is relatively modern. Equipment which is old and has been used intensively becomes prone to more frequent breakdowns and, thereby, increases the probability of disruptions in production and delivery schedules. Moreover, consistency in product quality is likely to be affected.

The methods and techniques for evaluating the manufacturing capability of new suppliers are the same as have been reviewed earlier in regard to assessing their technical and quality capabilities. Indeed, the composition of the team, or the terms of reference for the external evaluation agency, should be such as would cover all those aspects necessary to enable the buyer to evaluate the potential supplier's reliability and dependability in an overall sense.

(b) After-sales service

For certain products of a durable nature, adequacy of manufacturing facilities in relation to the order size, while important will by itself not

be sufficient in the selection of a reliable or dependable supplier. Other things remaining the same, a supplier who has already a well developed network of after-sales service facilities extending to the importers country (or vicinity) would naturally be preferred to another who may not have such facilities but may promise to provide them.

In this context, the suppliers' location assumes some importance. A supplier whose manufacturing facilities (and/or maintenance equipment and personnel) are located geographically, closer to the importer will, in general be better placed to respond to the buyers' after-sales services needs, than another one farther away.

3. Financial status

Financial strength of a potential supplier is usually not difficult to assess. Many companies publish annual company reports which include the main elements of their balance sheets and profit and loss accounts. An analysis of the balance sheet, in particular, can help to assess a company's status as to solvency, liquidity and profitability. It is true that companies sometimes manipulate their figures so that a balance sheet may hide, to some extent, the true financial status of the company. There is thus some degree of difficulty in assessing the financial strength of a potential supplier. Nevertheless, an expert analysis of balance sheets covering a couple of years will normally reveal the true financial status of the company being investigated.

Ratio analysis is often used as a method of ascertaining the financial strength or weakness of a firm. The solvency ratio indicates the ease with which an enterprise can meet its total outside liabilities, that is all current (short-term) and fixed (long-term) liabilities which it owes to other than its share-holders. A measure of the degree of solvency is the ratio of share holders' funds to total outside liabilities. So long as this ratio is greater than 1 (that is, shareholders' funds exceed total outside liabilities), a firm can meet its external liabilities from shareholders' funds. This ratio is however, often presented slightly differently as follows:

$$\frac{\frac{T_L - O_L}{T_L} \times 100}{\frac{T_L}{T_L}}$$

where  $T_L$  = Total liabilities  
 $O_L$  = Outside liabilities  
 $T_L - O_L$  = Shareholders' funds

A ratio of 50 per cent or higher is an indication of the solvency of a firm. The illustration below shows a simplified balance sheet with some of the major elements which constitute it:

ABC. Company:  
 Balance Sheet on 31.12.1989

Assets	%	Liabilities	%
1. Cash	15	1. Bank overdraft	10
2. Accounts receivable	15	2. Accounts payable	5
Total quick assets	30	Total current liabilities	15
3. Inventories	15	3. Fixed liabilities	25
Total current assets	45	Total outside liabilities	40

4. <u>Fixed assets</u>	<u>55</u>	4. <u>Shareholder's funds</u>	<u>60</u>
		(a) <u>capital issued</u>	<u>35</u>
		(b) <u>earned surplus</u>	<u>25</u>
<u>Total assets</u>	<u>100</u>	<u>Total liabilities</u>	<u>100</u>

In this illustration, shareholders' funds are 60 per cent of total liabilities as against 40 per cent of outside liabilities. Hence the company is solvent.

DATE:

REF. No.

NAME AND ADDRESS OF THE  
POTENTIAL SUPPLIERS' CLIENT

Gentlemen,

We are considering (Name and address of the potential supplier) as a prospective supplier for \_\_\_\_\_ (name of the product). We understand that you have recently bought the same or similar products from them. We would be grateful, if you would favour us with your opinion on their reliability as a supplier. To simplify the task, we enclose a short questionnaire and would highly appreciate it if you would complete it and return it to us.

Thanking you in advance for your co-operation, we remain,

Yours sincerely,

Name and address of the  
buyer's organization

Enclosures:

1. Questionnaire
2. Self-addressed envelope

Note: To be used selectively where effort and costs are justified and/or where information from other sources needs to be further verified, as discussed in pages 16 and 20.

QUESTIONNAIRE

QUALITY RATING:

<u>Excellent</u>	====
	====
<u>Very Good</u>	====
	====
<u>Fair</u>	====
	====
<u>Poor</u>	====
	====

DELIVERY:

<u>Excellent</u>	====	<u>dispatch before or on due date</u>
	====	
<u>Very good</u>	====	<u>dispatch on due date but requires some expediting</u>
	====	
<u>Fair</u>	====	<u>some delay and requiring a fair amount of expediting</u>
	====	
<u>Poor</u>	====	<u>considerable delay and requiring substantial monitoring and expediting.</u>
	====	

SERVICE:

<u>Excellent</u>	====
	====
<u>Very good</u>	====
	====
<u>Fair</u>	====
	====
<u>Poor</u>	====
	====

Please describe what you consider to be the strong and the weak points of the supplier in question:

(a) strengths

(b) Weaknesses

As long as total current assets exceed total outside liabilities the firm can be said to be under no threat of insolvency. A financially healthy supplier will be more reliable than one who could be insolvent.

Apart from this there is another particularly important ratio which reflects on the liquidity position of a potential supplier. It is only if a company has no liquidity problem, as far as cash resources are concerned, that it will be in a position to finance adequate inventories of raw materials, work in progress and/or finished goods. Such a firm can be relied upon for timely deliveries and, in addition, may be in a better position to ensure a



reasonable degree of price stability in supplies in case of a contract with deliveries stretching over a period.

The liquidity of an enterprise is reflected by the extent to which its current liabilities are covered by its current assets. There are usually two ratios used in this context: the current ratio and the quick ratio. These are obtained as follows:

$$\begin{aligned} & \text{Current assets} \\ \text{Current ratio} &= \frac{\text{-----}}{\text{Current liabilities}} \\ & \\ & \text{Quick assets} \\ \text{Quick ratio} &= \frac{\text{-----}}{\text{Current liabilities}} \end{aligned}$$

As seen from above, the difference between the two is that current ratio uses total current assets in the numerator whereas the second one uses only "quick" assets. The latter are assets which consist of cash and other current assets which can be converted quickly into cash.

Depending on the type of business, a current ratio of 2 to 2.5 per cent is considered to be satisfactory. As against this, a quick ratio of 1.5 and above would indicate that the company's liquidity situation is good.

The balance sheet also enables an assessment of the profitability of an enterprise. Although profits may not directly reflect on the financial soundness of a company, they do so indirectly. Firstly, and fundamentally, no business can survive for long without profits. In this sense, profitability is an index of the overall health of the company as well as the soundness of its management. However, profitability also has a bearing on its financial soundness. A substantial part of business expansion and operations of a firm are financed out of retained earnings. The pool of retained earnings will grow only if the company generates profits. Profitability and financial soundness cannot but be correlated.

The ratio which is used to gauge the extent of profitability is the ratio of net profit, before taxation, to net worth (shareholders funds). This reflects the operating profit being earned, by a company, on capital invested in the business.

4. Management capability

There are no two opinions in regard to the vital role which management capability has in ensuring efficient operations of a firm. In source selection, therefore, no importing organization can ignore an evaluation of potential suppliers' management skills for large value contracts involving the supply of technically complex plant and machinery. However, there is no simple way of making this evaluation.

One way is to look at the track record (turnover and profits) of the potential suppliers, more or less on the same lines as for assessing their financial strength. Another is to analyze management systems and styles. A progressive management, for example, will have a corporate plan for the medium term. It will have an organizational structure suited to its scale and range of operations. Similarly, the way existing manpower, technical in particular, is allocated is an attribute which distinguishes one enterprise from another.

In general, no two potential suppliers may have the same management ethics, styles and structures. A straight comparison of management "capability" of one firm with another, therefore, is not possible. The buyer might consider using a rating system to allocate points to such of the different management attributes as are important in the context of purchase to

be made. Such a rating system could be as in the table below.

Management capability rating system

<u>Potential Supplier</u>	<u>Management outlook</u>	<u>Organization</u>	<u>Deployment of manpower resources</u>	<u>Total</u>
1.	40	30	20	90
2.	35	40	20	95
3.	25	25	25	75

Note        The maximum for all three attributes is 100 points.

It should also be mentioned that there can be other management attributes that may be important and could be included. The three shown above are only illustrative. For example, how well industrial relations are managed may be an important attribute. This should then be included. It should also be noted that management capability is only one of the factors. A similar rating system can be used for comparative evaluation of overall supplier reliability and dependability, by allocating points to quality, technical capability and financial standing besides management capability.

5. Credit rating

As mentioned earlier, carrying out overseas surveys by the buyer himself to assess the overall reliability and dependability of new potential suppliers can often be quite expensive in manpower and financial resources. This may not be justified except in exceptionally high valued contracts. Fortunately, there are several credit rating and reporting agencies specializing in providing such investigative services for a fee. They furnish detailed reports on a company's production facilities and financial, and management status. These reports generally include a write-up on the history of the formation and growth of the company and also an impartial account of its present range of activities and other details which can be very useful to a buyer. A sample of such a credit report is given on pages (30-32). These are reproduced here by permission of Dun & Bradstreet - AG, Zurich, Switzerland.

C. Evaluation of existing suppliers

An importer is in a much better position to evaluate an existing supplier, based on his past performance, than is the case with a new supplier. The techniques and methods of this evaluation, however, usually tend to concentrate on performance in regard to (i) quality, (ii) delivery, (iii) service and/or price. It should be emphasized however, that it is important for the buyer to evaluate existing suppliers, from time to time as to technical, production, financial and management capabilities, using the methods mentioned earlier to assess their continued qualification as future suppliers.

1. The criteria

The method most commonly used for evaluating existing suppliers is referred to as the rating system. In its more widely used version it is like the grading system in student examinations. Each supplier's performance is separately evaluated in one or more of the four attributes, namely, quality, delivery, service and price. The overall evaluation comprises a weighted score of these four attributes, the weights being allocated on the importance which the importing organization gives to each. The choice of criteria is reflected by this scheme of weights.

Price may not be considered a relevant factor for supplier evaluation as offers would have to be evaluated before a specific contract. For this reason, supplier evaluation is at times confined to only three of these four factors, namely, quality, delivery and service, implying a zero weight for prices.

From the point of view of objectivity, it is a good practice for the management of the buying organization to decide on weighting diagram in advance and to stick to this for at least a year, at which time it may be reviewed. In deciding the relative weights, it is important to give serious consideration to the relative significance of each of the four attributes. For example, for certain products quality may be of paramount importance whereas, for others, it may be delivery or service (particularly after sales service) which is of importance.

If one attribute is paramount, the weight of this one will be 100, and those of the others, zero. This in effect means that vendors are evaluated on the basis of one attribute only.

The weighting diagram, thus, would not normally, be the same for all products which an organization may be importing. However, the same weighting diagram of a given product, should be used for all existing suppliers to ensure that the evaluation is unbiased.

## 2. Evaluation techniques

Several evaluation techniques and approaches have been developed by purchasing management. However, these have been developed largely in the context of domestic buying and multiple sourcing of the same product. Some of these methods are complex without necessarily enhancing their objectivity and usefulness particularly in the context of changing business environment. In fact, the results of even simpler methods in evaluation have often to be used as aids to judgement of the buying team in an organization.-

The method of supplier rating has been used in three different ways for evaluation purposes. These are:

- Categorical plan or model;
- The weighted points plan, and
- The cost ratio plan.

### (a) Categorical plan

The method is essentially judgemental. Each department in a buying organization, based on experience, forms views on the reliability and/or dependability of a supplier. Whenever, the question of supplier evaluation comes up, a meeting of the concerned officials of the different departments such as quality control, production, accounting, purchasing, etc. will be convened to review each suppliers performance. Suppliers may then be graded as "acceptable as first preference", "acceptable as second preference" and "not acceptable". Alternatively, the grading could be "good", "satisfactory" and "not satisfactory", or any similar gradation.

The method is simple. Where the number of suppliers is limited and the number and volume of transactions small, the approach may be as good as any. Moreover, data maintenance, specifically for the purpose of evaluation, is not required. The involvement of the different departments concerned ensures that the evaluation is not biased because of any single person's prejudice.

### (b) Weighted points plan

The approach is much in use because of the degree of objectivity it tends to bring to the process of evaluation. Moreover, it can be used to evaluate different suppliers for only one attribute, say quality conformance, or it can be used to evaluate and rank different suppliers based on criteria related to

reliability, dependability and competitiveness and taking into account performance with regard to other attributes such as delivery, service and price, in addition to quality.

The approach is particularly suited to a quick decision on sourcing for emergency and/or small value imports.

The first step which an importing organization has to take is to decide the factors with respect to which the supplier evaluation is to be carried out. As was mentioned earlier, the three variables which are usually considered are: quality, delivery and service. Price is often evaluated at the time of awarding the contract.

10/ Robert M. Monezka, Phillip L. Carter and John Hoagland, Purchasing Performance: Measurement and Control, Michigan State University, 1979, pp. 213-214, 218-219, and 231-233. P.J.H. Baily: Purchasing and Supply Management, Christine Jones, Martin Gore, David Salt and Maclolm Sauny p. 176-177 . "Vendor Rating" in Purchasing and Supply ManagementU, Institute of Purchasing and Supply, November 1987, pp. 29-31

The second step is to assign weights to each of these factors, based on the importing organizations judgment in regard to the relative importance of each for a given product, as follows:

<u>Attribute</u>	<u>Weightage %</u>	<u>=</u>	<u>For example</u>
<u>1. Quality</u>	<u>W1</u>	<u>=</u>	<u>50 %</u>
<u>2. Delivery</u>	<u>W2</u>	<u>=</u>	<u>40 %</u>
<u>3. Service</u>	<u>W3</u>	<u>=</u>	<u>10 %</u>
	<u>100</u>		<u>100</u>

The third step is to analyze the past performance of all the suppliers in regard to these attributes for the specific product for which the supplier list is being updated. For the quality conformance evaluation, the following will illustrate the process.

(i) Quality conformance rating

<u>Supplier</u>	<u>Qty/No delivered</u>	<u>Qty/No defective</u>	<u>Per cent defective</u>	<u>Score %</u>
<u>AA</u>	<u>150</u>	<u>30</u>	<u>20</u>	<u>80</u>
<u>BB</u>	<u>200</u>	<u>50</u>	<u>25</u>	<u>75</u>
<u>CC</u>	<u>175</u>	<u>25</u>	<u>13</u>	<u>87</u>

It may be noted that quality defects may not necessarily mean rejection of the defectives. There are sometimes defects which may not warrant rejection but only a penalty discount, provided that the deviations from the agreed specifications are acceptable to the buyer and the scale of penalties is agreed to in the contract.

The same is true of delivery schedules. There will be delays which may be acceptable to the buyer. However, the risk of a stockout will in general be an increasing function of the extent of delays in delivery. For this reason, the performance evaluation of different suppliers in regard to delivery should take into account this risk factor.

The steps involved in evaluating delivery are illustrated below.

(ii) Delivery rating

Set weightage to be given to each day of delay within a period as, for example, :

<u>No of days late</u> <u>(Periods)</u>	<u>Weight</u> <u>(applied to each day in period)</u>
1-10	1
11-20	2
21-25	3
25	4

Let the number of orders placed with each supplier be 4.

<u>Order</u> <u>number</u>	<u>Supplier AA</u>		<u>Supplier BB</u>		<u>Supplier CC</u>	
	<u>No. of</u> <u>days</u> <u>delay</u>	<u>Weighted</u> <u>delay</u>	<u>No. of</u> <u>days</u> <u>delay</u>	<u>Weighted</u> <u>delay</u>	<u>No. of</u> <u>days</u> <u>delay</u>	<u>Weighted</u> <u>delay</u>
				10x1=10		
1	4	4x1= 4	15	5x2=10	7	7x1= 7
2	13	10x1=10	8	8x1= 8	4	4x1= 4
		3x2= 6	18	10x1=10	23	10x1=10
3	9	9x1= 9		8x2=16		10x2=20
		10x1=10			12	3x3= 9
4	16	6x2=12	10	10x1=10		10x1=10
						2x2= 4
<u>Total weighted delay</u>		51		64		64
<u>Average per order</u>		12.8		16		16

If a supplier had been able to send supplies without delay he would get a score of 100. In the present case the score would be as follows:

$$\text{AA} = 100 - 12.8 = 87.2 \text{ or } 87$$

$$\text{BB} = 100 - 16.0 = 84.0 \text{ " } 84$$

$$\text{CC} = 100 - 23.5 = \text{ " } 84$$

(iii) Service rating

Service is a factor whose content will vary depending on the nature of the product and the duration and obligations of the supplier as per the contract, etc. In general, for a buyer, it reflects the speed of the suppliers' response and cooperation extended in contract monitoring, providing after sales service, training of personnel, etc., during the execution of the contract. If there are several considerations which need to be weighted in evaluating a supplier in regard to the service factor, then a system of weighting can be introduced with a grade point for each service attribute and

for each supplier.

Suppliers' Grade <sup>d)</sup> for different service attributes

Attribute	Weight	Grade out of 10			Weighted grade		
		AA	BB	CC	AA	BB	CC
Cooperation	2	8	9	7	16	18	14
Accuracy of documentation	2	7	8	8	14	16	16
Speed of response	2	7	8	7	14	16	14
After-sales service	4	8	9	8	32	36	32
<u>Total</u>	<u>10</u>				<u>76</u>	<u>86</u>	<u>76</u>

(c) Composite rating

Having evaluated and graded the suppliers on each of the relevant attributes, these are combined together into a composite rating using the weights already allocated at the time of setting the criteria for ranking.

	Weight	Supplier AA	Supplier BB	Supplier CC
Quality	50	.50 x 80 = 40.00	.50 x 75 = 37.50	.50 x 87 = 43.50
Delivery	40	.40 x 87 = 34.90	.40 x 84 = 33.60	.40 x 84 = 33.60
Service	10	.10 x 76 = 7.60	.10 x 86 = 8.60	.10 x 76 = 7.60
<u>Total</u>		<u>82.40</u>	<u>79.70</u>	<u>84.70</u>

Thus supplier CC is the best on the basis of the composite rating. However, if quality was of paramount importance, then the supplier CC would be the first to qualify. Similarly, if service was the most important attribute for the product to be imported, then supplier BB would be the choice.

The main shortcoming of the rating system is the arbitrariness of the weights which have to be allocated to different attributes and/or to different elements within each attribute. For this reason, cost ratio analysis is sometimes commended over the rating system for supplier evaluation.

(d) Cost ratio analysis

The central idea behind cost ratio analysis is that shortcomings in supplier conformance impose certain costs on the importer. Poor quality supplies will mean rejections, replacements, disposal, claims, etc. It could also mean latent defects and poor product performance. All these would ultimately impose costs (most, if not all, measurable) on the importer.

Similarly, delayed deliveries or short shipments could mean stockouts and production disruption. To avoid these, the importer may have to rush for emergency supplies and incur additional costs. Even if replacement supplies are not actually arranged, it is possible to attach penalty points for each day (or week) of delay on an increasing scale and attach monetary values to these points. This would be the cost of delays which can be used in supplier

evaluation.

Depending on the nature of the product, poor service may mean lack of prompt response to the buyer's queries on delivery dates, shipment details and similar other matters which are required to be transmitted during the contract period. Inadequate and delayed responses mean additional communication costs to the buyer - e.g., telephone calls, telexes, etc. Poor after-sales service in case of plants and equipment may mean more frequent breakdowns and production stoppages, or alternative arrangements involving higher costs. All such costs are measurable. In its essence, the cost ratio method seeks to aggregate all such costs for each supplier for a given contract. The ratio of these costs to the value of the contract is then used as an index for supplier evaluation.

To be able to apply the cost ratio method to compare supplier performance, a buyer will have to keep a systematic record of all these additional costs for each supplier on a contract to contract basis. He will only then be in a position to work out the per unit cost of supplies made, that is, the total of such extra costs divided by the total contract value over a given period. A comparison of these per unit costs for each supplier will give a measure of the relative efficiency (or inefficiency) of the suppliers.

Alternatively, the price quoted, and which forms the basis of the contract, may be adjusted for the additional costs. The adjusted price will then provide a measure of the effective price or cost of supply of a given product by different suppliers. This itself will help evaluate the relative performance of different suppliers.

It should be noted that such a straight comparison may not be possible or even relevant. The small volume of imports of some importing organizations in developing countries may mean that only one supply contract is concluded with only one supplier in a given procurement cycle. Therefore, a comparison of suppliers for such costs or using adjusted prices is not possible. However, if the buyer does maintain a systematic record of such costs over two or three years, a procurement officer will be in a position to present his assessment, to a purchase committee (or an offer evaluation committee) his assessment, more convincingly by indicating the magnitude of extra costs which may have to be associated with a particular supplier. Even if the price offer of the suppliers is not adjusted for such costs, the committee members will have a much better basis for offer evaluation and supplier selection than without such information.

D. Project imports and supplier evaluation

The methods outlined above are meant to be used for standard products purchased, if not repetitively, at least fairly frequently. These would include consumer goods, (non-durables or durables), agricultural and industrial inputs, office equipment, general purpose machinery, transport equipment etc. There are classes of imports which are qualitatively different, namely project imports, the volume and variety of which are on the increase in developing countries. Supply contracts in these cases often involve the import of goods (e.g., plant and equipment), technology (process know-how, engineering designs and drawings) and services (engineering and other necessary skills).

Because of the complexities involved in (i) proper selection of designs, (ii) selecting and organizing suppliers of different products and/or services, and (iii) scheduling, coordinating and supervising fabrication, shipment and installation of plant and machinery, the importer generally selects a prime contractor to carry out these tasks. There are many varieties of contracting arrangements applicable to such a situation, the basic difference being in the extent of the relative roles and responsibilities of the buyer and the prime





a: quality	(a)	(a)	(a)
b: delivery	(b)	(b)	(b)

Trial run results

Any other (specify)

Recommended for future work	YES	NO
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If no, reason:

<u>Name and Signature of the reporting manager</u>	<u>Title</u>
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Date:

V. SOME ISSUES IN SUPPLIER SELECTION

1. Evaluation and supplier selection

Supplier evaluation through capability surveys at the pre-contract stage or performance rating at the post-contract stage is an aid, and an important one at that, in supplier listing and selection. Thus, different methods of evaluation help the buyer, initially, to decide on preparing a list of reliable and dependable potential suppliers and, later, to evaluate their offers, through, for example, cost ratio analysis. However, there at times considerations which may cause the buyer to deviate from strictly following the rating or ranking system.

2. Other considerations

Some of these other considerations may be:

- Government directives;
- Countertrade possibilities;
- Long-term relationship;
- Multiple sourcing.

(a) Government directives

Sometimes, government policy may seek either to encourage trade links with one country or enterprise and discourage it with another. Many developing countries have special bilateral trade and payment arrangements with other countries. Through the instrument of foreign exchange allocations, governments may encourage imports of specified products to be made from suppliers in those countries.

Thus, government intervention of one sort or the other can, conceivably, alter the decision of the buyer taken on the basis of standard supplier evaluation methods and techniques.

(b) Countertrade

In the event of balance of payments difficulties in developing countries, importers have had to devise ways and methods of meeting some of their import requirements without recourse to the foreign exchange resources of the

country. Countertrade, in its various forms, is one such mechanism which has been used to import goods against exports of goods and/or services directly by the importer himself or indirectly through triangular arrangements. However, this means that supplier selection is influenced, among other things, by the willingness of the party to enter into such an arrangement with the importer.

(c) Long-term relationship

In international commerce, it is not uncommon for an importer (as well as an exporter) to look for and seek to cultivate long-term trading relationships for the advantages which such relationships offer. A long-term trading relationship is a sort of insurance for the importer that, in the event of global shortage for example, the supplier will give some preference in meeting the requirements of his trading partner. Thus, even if such a supplier's delivery rating is not outstanding, but is within an acceptable range, the importer is likely to continue buying from him if a relationship has been established which has stood the test of time.

(d) Multiple sourcing

This consideration stems from the old adage "do not put all your eggs in the same basket". Normally, the importer would not want to split his requirements and spread these if he is satisfied with the performance of an existing supplier. However, if the order quantity is large there is some advantage to be derived by avoiding dependence on one source and selecting more than one supplier. Again, this approach offers an insurance against delivery problems which may arise due to unforeseen difficulties of the supplier, e.g., a strike by plant workers, plant breakdown, port workers' strike or congestion at the exit port, etc.

The point to note is that there are, at times, other considerations, seemingly extraneous, which a supplier may need to take into account in supplier selection.

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