

Management for Professionals

Ulrich Weigel
Marco Ruecker

The Strategic Procurement Practice Guide

Know-how, Tools and Techniques
for Global Buyers

 Springer

Management for Professionals

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Know-how, Tools and Techniques
for Global Buyers

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ISSN 2192-8096

Management for Professionals

ISBN 978-3-319-57650-3

DOI 10.1007/978-3-319-57651-0

ISSN 2192-810X (electronic)

ISBN 978-3-319-57651-0 (eBook)

Library of Congress Control Number: 2017940241

Translation from the German language edition: Praxisguide Strategischer Einkauf by Ulrich Weigel and Marco Rucker, © Springer Fachmedien Wiesbaden GmbH 2015, All Rights Reserved.

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Printed on acid-free paper

This Springer imprint is published by Springer Nature

The registered company is Springer International Publishing AG

The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

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Preface

Science Meets Reality: A Guide for the Modern Buyer

Four years have now passed since the first edition of this book was published in German followed by a second edition in 2015. In order to consider the international environment of the procurement function, the original German edition is now updated and published in English language.

As there is nothing more constant than change, there is once again news to report from the world of Procurement. The declining price of oil and the collapsing Rouble are just two examples. For very different reasons, China, once a major player on the world procurement stage, is settling for a considerably smaller international role over the medium term, while other Asian states bound ahead. South-East Asia is currently being touted as a new business location with great potential. The Association of Southeast Asian Nations (ASEAN), with a total population bigger and considerably younger than the entire EU, is well on its way to becoming a duty-free economic zone. Leading the way here are Indonesia and Thailand; however, the Philippines, Malaysia, Vietnam, Myanmar, Brunei, Singapore, Laos, and Cambodia are also adding clout.

In creating this English language edition, consideration has now been given to recent developments in the area of information technology. The digitalisation of business processes has become an increasingly important force driving the modern corporate organisation. Particularly in the area of procurement, where intensive networking and cross-boundary collaboration is required, innovative transaction options are offering enormous potential for the execution of electronic business processes. An entirely new chapter focuses on the theme of eProcurement.

While bringing you the English edition, the authors have also experienced personal developments. Marco Ruecker and Ulrich Weigel now provide further insights into the theme of Procurement in their roles as advisors, coaches, and tutors, further enriching what is already a wealth of experience involving many industries. As a result, this book will take a more detailed look at the topic of management (even suppliers need to be managed) and the right way to deal with monopolists.

This book has been realised thanks to the friendly support of the SAM Xlation and Coretrust companies.

Eschenburg, Braunfels
March 2017

Ulrich Weigel
Marco Rücker

Preface for the First German Edition (Translated from German Original Text)

Science Meets Reality: A Guide for the Modern Buyer

There are plenty of professionally written books and articles that address the theme of procurement; however, few are penned by authors who have gained such a wealth of experience within this realm or who bear the relevant responsibility. And that is why this book will avoid muddying the waters with extensive theory or a lack of practical relevance, destined to gather dust on a shelf. Instead, we have aimed to provide the reader with 200 plus pages of strong, occasionally humorous and largely entertaining text, which should serve as a useful tool for both young professionals and experienced purchasing experts as they navigate working life.

Basic scientific knowledge will be coupled with tried-and-tested purchasing techniques, as well as professional advice drawing on positions of responsibility across five different industries. Using methods that have developed and evolved over the course of 25 years, the reader will be shown how to implement, simply and profitably, the most varied of purchasing techniques anywhere in the world, for example simple methods for determining the value of items without knowing the supplier's calculation. Answers will be provided for the following: Is it possible to manage heterogeneous supplier structures while tailoring to industry requirements? What approach should be taken for partners from the various cultures? What is needed to survive procurement crises and what proactive measures can be taken to minimise their impact? How are employees managed, including those over long distances, and is it possible to improve the standing of procurement both internally and externally?

Just a few examples of the content covered in both theory and practice in this book.

Marco Rücker has provided the scientific basis, while Ulrich Weigel has shared his wealth of experience. Drawing on countless purchasing negotiations in the USA, Western, Southern and Eastern Europe, Vietnam, Malaysia, and India, however primarily China, Japan, and Korea, assessment of the different cultures and thus behaviours has been possible. In addition to the basic purchasing information, Global Sourcing (with a focus on Asia), Supplier Management, and Purchasing

Negotiations will be discussed in detail. The individual chapters will be rounded off with a number of practical examples, thus providing guidance for both managers and employees with experience in procurement, as well as buyers just starting out in their career and looking to move from operational tasks to strategic procurement with managerial responsibilities.

This book is also ideally suited as teaching material for students of Purchasing, Logistics, and Supply Chain Management, because a successful career beckons any buyer who is able to improve quality, minimise risks, and thereby measurably lower procurement costs over the long term along the supply chain.

A big thank you for the support provided by Leica Camera AG, where both authors are currently employed: Ulrich Weigel as Vice Chief Operating Officer and Head of Purchasing and Marco Rucker as Industrial Engineer in Strategic Purchasing, responsible for process development in the supply chain, risk management, and strategy development, among other things. This book has also been realised thanks to the friendly support of the Bisnode and Pool4Tool companies.

The authors also wish to extend a special thanks to their colleagues Ms. Carolin Knebel, Mr. Wolfgang Schermuly, Mr. Frank Kraft, Mr. Jan Meyer and photographer Michael Agel, as well as Professor Sebastian Heilmann from the University of Trier, Mr. Jochen Bruns from NEXUS21 GmbH, and Mr. Peter Hermann from Sell GmbH. Intercultural experts Dr. Kim Nam Hui and Mr. Shuzo Matsushita also provided valuable input, particularly for the chapters concerning Asia.

Not forgetting StudiumPlus, an initiative from the Central Hesse Technical University, which provided Marco Rucker with the opportunity to explore, in both theory and practice, the various aspects of purchasing as part of his industrial engineering studies.

And, last but not least, thank you to Maria Troussas and Tanja Weigel and all our friends who provided advice and assistance over the past 15 months, lending support with understanding and patience.

Eschenburg, Leun
February 2013

Ulrich Weigel
Marco Rucker

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1.1 Introduction

In recent years, the significance of Purchasing has increased at a rate greater than in almost all other business functions. This book, amongst others, is evidence of a trend that is fairly obvious and caused by the fact that, in academic teaching as well as in practice, Purchasing has for a long time been treated as an afterthought—more so than any other area of Business Economics. In teaching, the topics of Purchasing, Materials Management and Procurement were filed subordinately somewhere under the subjects of “Production” and “Logistics”. The organisational structures of companies show a similar picture. Central Purchasing departments, where they exist, have only existed in large corporations. In most businesses, employees were assigned responsibility for the material supply of their particular departments. They have also negotiated prices, monitored delivery dates and complained about poor quality. But cross-functional approaches that had long been established in such areas as Distribution, Production, or Marketing only developed in Purchasing a few years ago.

This change of thinking within businesses has not been a matter of chance. On the contrary, changing conditions have made Purchasing the focus of business transactions. Increased global competition, ever shorter product life cycles, and steadily increasing pricing pressures are only some of the factors involved. Companies wishing to perform successfully in the market are forced to “think outside the box” by organising not only their internal but also their external supply chains as efficiently and economically as possible. In this context, Purchasing is given a totally new range of tasks. Merely executing and supervising order procedures is being superseded by long-term management of complex supply chains—a change that has occurred in many, but not all, enterprises, and for this change to occur, new and innovative approaches to management are needed.

1.2 Purposes and Aims of Purchasing

A uniform and coherent definition of the Purchasing business function cannot be found in current Business Economics literature. For now, prevailing ideas and concepts are too diverse to give a consistent picture. Traditional concepts such as Procurement and Materials Management are gradually disappearing while keywords such as “Strategic Purchasing”, “global procurement”, and “Supply Chain Management” find their way into academic discourse. This is evidence of the change that has occurred in Purchasing in the last few years and that will probably continue in the near future. Yet the core task of Purchasing has remained the same. Purchasing is in charge of supply into the organisation. Its responsibility is to ensure the availability of supplies such as products, facilities, resources, and services. The classic aim of Purchasing—to secure the right products in the right quantity and quality at the right time and the right place, while considering economic principles—still holds true. But due to the increased importance of purchasing activity, additional strategic approaches have been developed. Purchasing activities need integrated and long-term planning. Suppliers must be developed to become strategic partners, and procurement markets must be developed globally. Out of these considerations, an extended field of action has evolved: Strategic Purchasing. This development often leads to a division of personnel within Purchasing according to areas of operational and strategic areas of competence. While Operational Purchasing is in charge of the routine handling of order processes, the Strategic Buyer develops the long-term framework conditions subject to the business strategy.

But this is not a complete picture of the Buyer’s field of activity. Working with projects in the context of product development processes is a further extension of the Buyer’s activities. Apart from the Project Manager’s considerations of costs and deadlines, suppliers are more frequently being engaged in technology partnerships at an early stage of development projects, which means that Purchasing also obtains new significance in project work. Its tasks in this respect are, amongst others, to help, to coordinate, to mediate, and to actively organise the process.

In summary, there are three basic functions of Purchasing today:

- Operational Purchasing: Securing supplies
- Strategic Purchasing: Long-term planning
- Project Purchasing: Support of the product development processes and other business areas

It is clear that the Buyer’s area of responsibility can be quite different, according to the respective range of functions. Depending on line of business and significance, further areas of responsibility may open up. But the basic aim of Purchasing remains the same—to secure the organisation’s supply of the required factors of production.

1.2.1 Operational Purchasing

Basically, Operational Buyers assume the classical purchasing functions with regard to routine operations. As a rule, they will make recourse to the conditions established by the Strategic Buyer. Within the tasks of Operational Purchasing we have, for example, the handling of routine order processes, expediting deliveries, operational planning of procurement activities in terms of demand planning, scheduling, and the processing of returns and notices of defects. The main aim of Operational Purchasing is to secure the availability of materials at any time and also to achieve optimum stock levels. As this field of activity is closely connected with the business function of Material Management, Operational Purchasing activities are often located there. Thus, in classical Purchasing departments, necessary latitude to perform strategic tasks is realised without a need for additional personnel.

1.2.2 Strategic Purchasing

In the context of strategic considerations, activities prior to the actual order process have become increasingly important. This function is assumed by Strategic Purchasing. Strategic Buyers make decisions that are beyond the scope of day-to-day operations. In doing so, they create the framework conditions of Operational Purchasing. The first step is to define the basic strategic direction of procurement activities in terms of supplier, commodity groups, and risk strategies that support the overall business strategy. Furthermore, Strategic Buyers research potential procurement markets, negotiate framework agreements, and manage the supplier portfolio. Last but not least, they are also responsible for process improvements within the value chain, which also means questioning their own function. Ideally, this results in the continuous optimisation of the whole procurement process including its points of interface.

1.2.3 Project Purchasing

Project Purchasing is a multidisciplinary procurement function within the context of product development projects in which Purchasing is increasingly gaining significance. One of its main tasks is to co-ordinate all purchasing activities within the scope of the project. Project Purchasing therefore represents the suppliers involved, and it also represents the interests of the Purchasing department in the project team. In doing so, it makes use of the resources of Strategic Purchasing and hands over the established framework conditions once the project has been approved.

The importance of Project Purchasing becomes especially clear if one considers that roughly two-thirds of the product costs are determined in the early opening stages of development projects. For this reason, the early involvement of Purchasing

at the start of the project is becoming increasingly important and should be backed by the management.

Project Buyers are also involved in the case of complex, indirect supplies with long lead times. This may be, for example, capital investments such as new plant, machinery, or workshops. That is why Project Buyers need a sound basic knowledge of technical and commercial aspects and a distinct understanding of Project Management.

Practical Tip

As shown in Fig. 1.1, the tasks and responsibilities of Strategic, Operational, and Project Purchasing are not always clearly separated. The crucial question is to which part of the product life cycle the supplied item belongs. At the beginning, Project Purchasing will have the greatest responsibility, but depending on the project these tasks may also be performed by the persons in charge of Strategic Purchasing. From the beginning, Project Purchasers monitor the whole product development process and organise the external value chain. Once production readiness and release have been achieved, the project is committed to Operational Purchasing which will safeguard the material supply with respect to cost, quality, and time. But this holds true only as long as the supplier delivers in accordance with the previously agreed framework conditions. In cases of deviation, Strategic Purchasing will again take up the responsibility as long as these have not been addressed. In practice, this means that while Strategic Buyers are still leading their commodity groups strategically and company-wide, their tasks may be dominated by more technical demands according to the industry. “Front Loading” is the key phrase here—the earlier Strategic Purchasing is involved with selected suppliers, the more efficient the results will be for the company. Ideally, this



Fig. 1.1 Purchasing-fields of action and points of interface

involvement already takes place in the early innovation stages. The result is that not only are innovations and time-to-market improvements contributed—often free of charge—by the suppliers, but also costs and suppliers are brought under professional control from the outset.

1.3 The Growing Importance of Purchasing Within the Company

When considering the reasons for the growing importance of Purchasing, one will inevitably end up at costs. No other business function can influence costs and consequently the company results to such an extent as Purchasing. This is mainly due to the fact that many companies tend to reduce their own vertical range of manufacture. In the context of the division of labour, companies increasingly tend to concentrate on their own core competences which results in higher external value creation. Thus, in German manufacturing enterprises, the proportion of material costs measured against turnover has doubled during the last 20 years. With an external material quota of often more than 50%, Purchasing is responsible for the lion's share of operating costs.

On the one hand, this shows how great the responsibility of Purchasing is. On the other hand, this fact shows that Purchasing has a direct influence on the operating results and the return on investment (ROI) of the company. The latter may be illustrated by a ROI model.

In Fig. 1.2, it is assumed that 50% of the original costs are caused by bought-in parts. If one succeeds in cutting down this pool of costs (with several methods which will be explained afterwards) by 4%, gains will increase from 10 million euros to 12.6 million euros. The operating margin will increase to 9%, from which comes an increase in ROI to 36%. This shows that a 26% gain in profitability is achieved by a material cost reduction of only 4%!

One can also see the influence of Purchasing on the return on investment with regard to inventory. By reducing stock, for example, by establishing consignment stocks, the necessary operating capital is reduced, which in turn results in a positive effect on asset turnover and also on return on investment.

In a further example calculation, several means of achieving increased profits shall be compared.

In Fig. 1.3, the effects of increasing sales are compared to the effects of labour cost reductions and material cost reductions. On the premise that costs will develop proportionally to the turnover, an increase of 5% in turnover will also mean a profit increase of 5%. With unchanged framework conditions, labour cost reductions by 5% result in a 25% profit increase; however, the greatest increase is achieved by a 5% material cost reduction. In this case, profit is increased by 50%. This leverage effect shows the direct influence of Purchasing on the performance of the company.

But the growing importance of Purchasing is caused not only by its contribution to the performance of the company; internal as well as external challenges have

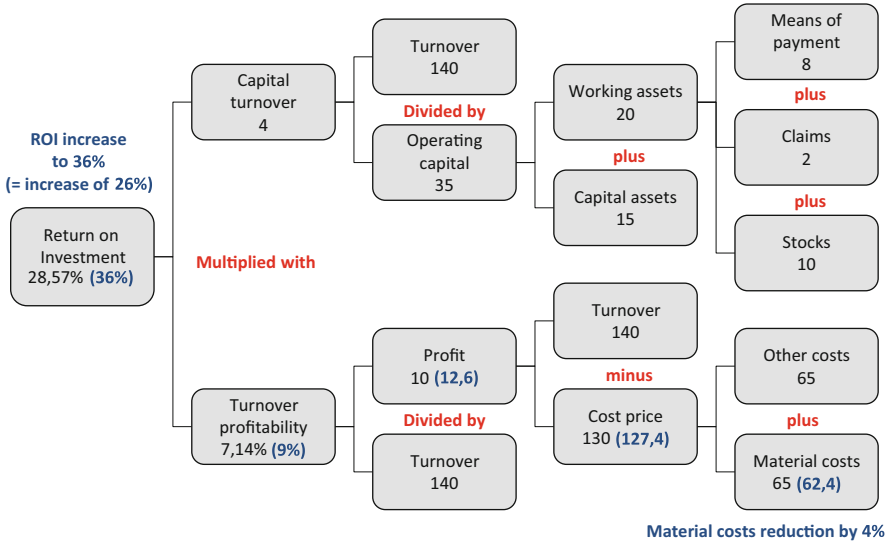


Fig. 1.2 Influence of purchasing on the return on investment (data in million euros)

	Base values in Euro	Turnover +5%	Labor costs -5%	Material costs -5%
Turnover	100.000	105.000	100.000	100.000
Material costs	50.000	52.500	50.000	47.500
Labor costs	25.000	26.250	23.750	25.000
Other costs	20.000	21.000	20.000	20.000
Profit	5.000	5.250	6.250	7.500
Change in profit		+5%	+25%	+50%

Fig. 1.3 Effects of sales increase compared to labour costs reduction and material costs reduction

enlarged the range of tasks Purchasing must fulfil. Increasing costs in the R&D sector, shorter product life cycles, and ever-advancing globalisation provide new challenges for companies to face. In this context, functioning, flexible, and efficient value chains and technology co-operation contribute immensely to the performance differentiation of the company, e.g. through shorter delivery times, higher quality levels, and cost leadership. Cross-departmental management of the internal and external added value may thus make the difference with respect to competitors.

As a consequence of these challenges, an integrated and cross-departmental management of the company’s supply is absolutely necessary, and therefore the requirement for a Purchasing department that has a strong position becomes clear.

1.4 Future Challenges to Purchasing

In the future, the range of purchasing tasks will increase disproportionately. Even today, a lot of business functions such as Strategic Planning, Commercial, Risk Management, and Project Management are included in this range. It is therefore clear why Purchasing has already reached a strong position in many companies. However, the greatest challenge will be to further enhance the strategic position of Purchasing within the company. Despite its growing importance, procurement activities by other departments are still the order of the day in most companies. This so-called “maverick buying” (meaning uncoordinated purchases) in many companies quite often amounts to 20–30% of total purchasing. In this context, a lot of explanatory work is required, and one’s words must be followed up with action. Specialised departments cannot command the same information and market knowledge that Purchasing should have; quite often they will react with surprise when unrealized benefits are shown to them.

To accomplish this, Buyers must have the necessary know-how at their disposal. This particularly includes a basic technical understanding of the products to be procured and of their manufacturing processes, in addition to the requirement for ample commercial knowledge. Only with such background knowledge will Buyers be able to purposely apply the variety of available purchasing techniques and be taken seriously in discussions with technical departments. This is the prerequisite for optimally combining in-house requirements with the competencies of suppliers and thus contributing to the company’s goals.

Concluding technology co-operation agreements with suppliers and integrating them early in the product development process becomes increasingly important, especially in the light of shorter product life cycles and reduced vertical ranges of manufacture. For this, close and long-term partnerships must be formed and developed.

With regard to potential supply markets, Buyers must meet the challenge to open up and exploit new, interesting regions for their own companies without losing sight of the risks involved. One must never forget that an increase in external added value also means an increased dependence on this added value. Significant hazards and risks are hidden in global and highly branched supply chains. For example, the impacts of natural disasters on the other side of the world may become relevant to one’s own production line as a result of global purchasing activities. The failure of merely one component may cause a standstill of the whole value chain. Purchasing has responsibility to proactively devise risk strategies in order to counter such scenarios with suitable measures.

Another challenge is presented by the personal requirements Buyers must meet to successfully occupy their increased scope of responsibilities. Apart from intercultural competence, technical and commercial know-how as well as negotiating skills, Buyers will need soft skills and leadership abilities. Although only a few Buyers bear leadership responsibilities in a direct sense, negotiating internal conflict and the management of supplier partnerships call for a high degree of leadership competence. Suppliers must be led, motivated, encouraged, and warned in

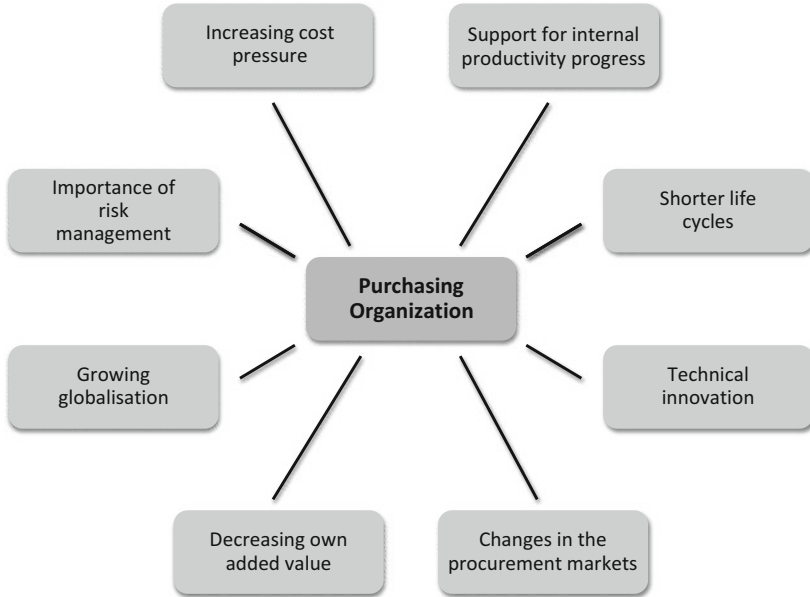


Fig. 1.4 Challenges to the organisation of purchasing

exactly the same way as members of staff. That is why communication skills, assertiveness, and social intelligence are among the essential requirements modern Buyers must meet.

To cope with the challenges shown in Fig. 1.4, diverse, tried-and-tested approaches and management methods will be suggested. These serve to enable modern Buyers to proactively manage their scope of responsibilities and to meet the requirements of their new, strong position within the company.

2.1 Strategic Principles

The importance of Purchasing with regard to business success has been discussed in Chap. 1. In many companies, this insight is already fixed firmly at the front of one's mind. But the acknowledgement of this fact alone is not enough to achieve the strategic and integrated management of the company's supply. The next step must be to develop an approach by which such an integrated view is made possible and thus specific courses of action are opened up—Purchasing needs a strategy.

Basically, the term “strategy” refers to an operational framework which is geared to the attainment of long-term goals. The strategy forms the highest level in the planning process, answering the question: “What does the company want to achieve?” Frequently, the strategy is derived from a company vision, a formalised picture of the company in the future. So for example, the Volkswagen car company has stated its vision to become the biggest car company in the world by 2018. In this way, a vision has a normative nature; it is often compared to the Pole Star as it is setting the agenda.

From this vision, the business strategy is derived, but it will still depend on many factors. In defining the strategy, the following issues must be taken into consideration:

- What are my core competences?
- Which services do I offer?
- How do I distinguish myself from competitors?
- What are the needs of my stakeholders?
- What is the focus of the added value?
- What opportunities, potentials, and threats exist?

The main function of a strategy is to set out the requirements for future business success and to prevent business-critical situations. In most cases where a company is battling for its existence, it will be too late to develop a strategy.

Fig. 2.1 Annual strategy cycle



Following the overall business strategy, the next step will be to develop functional strategies such as marketing, development, and distribution strategies. At this stage, the Purchasing department also enters the strategy process by defining its purchasing strategy and aims, deriving courses of action from this strategy and implementing them. The crucial question in this context is in how far Purchasing can contribute to the attainment of the strategic goals of the company.

Strategies cover a period of 3–5 years. This does not mean that the strategy is set in stone during this period. Rather, the strategy serves as a framework for performance that needs to be reviewed regularly; on the one hand to quantify the level of implementation and on the other to adapt the basic strategic direction to changing framework conditions.

Consequently, a process of recurring reviews is established, as shown in Fig. 2.1.

2.2 Principles of the Purchasing Strategy

In planning a strategy, fundamental principles must be kept in mind to ensure that the strategic considerations will be successfully implemented rather than being accepted in name only. For this reason, strategies always cover a long-term period (of 3–5 years) although their validity during this period is not necessarily permanent. Strategies often have a high degree of uncertainty due to their predictive nature. Markets and framework conditions may sooner develop in another direction than that anticipated during the strategy development process. Therefore, purchasing strategies must be flexible and checked against changing market conditions at regular intervals and adapted accordingly.