Level 4 Diploma in Procurement and Supply

D2 - Business needs in procurement and supply

EXAM EXEMPLAR QUESTIONS

QUESTIONS AND INDICATIVE ANSWER CONTENT
Q1 Learning outcome: 1.0

(a) Outline the differences between production materials and capital items. (5 marks)

(b) Describe the different approaches to the purchase of production materials and capital items. (20 marks)

Marking scheme

(a) This is intended as a straightforward question that requires an explanation of the key differences between production and capital items.

• Without being too prescriptive candidates should be aware that production materials are financed from revenue budget (expense account).
• Production Materials items are bought to be consumed (used) or transformed before becoming incorporated into the final product. There is often a wide range of such items.
• Capital items are fixed assets used to produce goods. Such assets are used to generate revenues beyond the accounting period in which they were purchased. These items are financed by / chargeable to a capital account rather than to expenses.
• The demand for such items is derived that is they are purchased for what they do rather than what they are. Capital acquisition is less frequently undertaken and their acquisition often changes the strategic position of the organisation.

5 marks for answers based on the above answers. (5 marks)

(b) Without being too prescriptive candidates should point to the following in their description.

Production Materials:
• Such items are often bought on a repetitive basis, possibly against forecasted demand and linked to a computerised stock management system such as MRP, ERP or SAP system. Repetition often allows for buyer /supplier relationships, purchasing systems and cost reduction programmes to be developed or instigated.
• Purchasing inevitably plays a key role in the acquisition of such items including supplier selection, price negotiation, and contract formation and supplier relationship management.
• Application of the operational objectives of the 5 rights of purchasing applies particularly to productions materials.
• Expenditure might be segmented using tools such as Kraljic and different purchasing strategies developed depending on the criticality of the items / supply side risk and or impact on final price. Purchasing has significant control over such activities.

Capital expenditure:
• Unlike operational items which involve purchasing day to day involvement, capital items are bought far less frequently and are bought for what they can do rather than part of the end product.
• A key distinction lies in the originator of the purchase decision and the decision making
unit. Often production (or other function such as technical staff) will determine the need, specification and in many instances initiate the acquisition by, for example, requesting prices, undertaking product trials and tests and so on.

- Purchase decisions are more likely to be made on machine (technical) attributes rather than commercial aspects. This does not mean that purchasing is excluded from the purchase process but rather they might play a different role. Typical contributions include;

  - Life cycle considerations / whole life costs
  - Countering the possible prejudice of users
  - Provision of commercial, contractual and negotiating expertise
  - Identification of alternatives to outright purchase
  - Identification of grants
  - Assisting with the disposal of the displaced asset.

Answers can place equal emphasis on each but consideration should be given to answers that develop fewer points but in more depth in either area. High scoring answers will provide detailed descriptions of the differences. Answers that provide valid points but little or no descriptions of the differences should attract lower marks.

(CIPS study guide reference: Chapter 1, section 3, page 9)
Q2  Learning outcome: 2.0

Explain **FIVE** reasons why a purchaser might favour an ‘output’ specification over a ‘conformance’ specification.

(25 marks)

Marking scheme

This is a wide-ranging question, and candidates should explore fully why purchasers might favour ‘output’ specifications over ‘conformance’ (or ‘input’) specifications. Answers should clearly delineate **FIVE** different reasons for a purchaser to favour an output specification; and there are many reasons from which to choose.

**By way of examples only, answers might state that:**

- It can be much quicker to write an output specification
- An output specification is likely to be a very much shorter document than a conformance specification, making it much easier and cheaper for all interested parties to handle, amend, read and understand.
- An output specification places all of the risks of non-achievement of performance squarely with the supplier, and not with the purchaser: if the required performance is not met, then the supplier must remedy the situation, wholly at his time and cost;
- An output specification allows for innovation and new approaches to achieving the desired/required performance, and to dealing with any problems that arise; this encourages flexibility and innovation in the marketplace, and it can be argued that it encourages new start-up companies and diversification of existing companies;
- An output spec requires little or no detailed technical knowledge on the part of the purchaser;
- An output spec will avoid reliance on existing suppliers and their brands/IPR.

These are examples only, and all other valid reasons should be accepted and given marks appropriately. Higher marks should be awarded for the more comprehensive and well-reasoned explanations, which give good coverage to legitimate reasons for preferring output specifications.

Maximum marks available for this question are therefore: 5 x 5 = 25 marks.

(25 marks)

CIPS study guide reference: Chapter 4, section 2, pages 61 - 69
Q3  Learning outcome: 3.0

(a) Discuss TWO examples of standard ‘Model Form Contracts’.  

(b) Explain THREE potential advantages of using ‘Model Form Contracts’.

Marking scheme

(a) Answers should discuss any two examples of models forms of contracts from which standard model form (SMF) contracts might be obtained. For high marks, candidates should set out in their descriptions the title of the organisation and, if appropriate, the title of the SMF which that organisation offers. Answers may also describe appropriate circumstances for use of that particular SMF; typically this will be for low-value, regularly-purchased items, where there is no bespoking or specialised one-off elements, but there are exceptions to this such as the New Engineering Contract (NEC3).

NB. The question is NOT based on what SMFs are; nor why they are useful. It is the sources that are being sought here.

Answers should therefore describe any TWO of the various trade bodies and professional bodies which publish or make available SMFs. There are several such bodies to choose from. Examples would include The New Engineering Contract (NEC3), various of the CBI’s SMFs; and the CIPS SMFs.

Up to 10 marks are available here, 5 for each example described, with higher marks being awarded to the more detailed and comprehensive descriptions. Maximum marks available for this part of the question are therefore 2 x 5 = 10 marks.

(b) Answers should set out three different appropriate advantages, and give strong explanations. There are several advantages to mention. Examples could be: model form contracts are appropriate to low-value, regular spend items, where there is no bespoking or specialised one-off elements and they will therefore save time and money that would otherwise be spent in writing a separate contract for each transaction.

Model form contracts will usually already be very familiar to both parties to a transaction, and should therefore be readily understood and recognised. This can save considerable time and money in avoiding disputes and misunderstandings, involving potentially very expensive legal advice and representation; even Court action.

Up to 15 marks are available here, up to 5 marks for each ‘advantage’ explained, with high marks being awarded for more detailed and comprehensive explanations.

NB. This question is about the advantages of using Model Form Contracts; and is not asking what Model Form Contracts are – this is at best a subsidiary element of the question, and any answers offering mere definitions should receive few marks.)

CIPS study guide reference: Chapter 7, section 4, pages 119 - 121
Q4  Learning outcome: 4.0

(a) Outline THREE possible reasons for the failure of an outsourcing contract.

(b) Discuss FIVE possible actions that could be taken to ensure success in outsourcing contracts.

Marking scheme

(a) Pass grade answer content is likely to include:

Reasons for the failure of an outsourced activity:

• Failing to specify in sufficient and measurable detail the nature and scope of the activity outsourced. Thus the supplier was required to guess what is the buyer wanted while the buyer may have been dissatisfied with what was actually delivered.

• Poor terms and conditions being negotiated by the buyer. Linked to the specification, terms and conditions are an important part of the negotiation package. Failure to secure a set of terms and conditions can leave the buyer vulnerable to exploitation by the supplier. The presence of exclusion or limitation of liability clauses inserted by the seller can severely restrict the action a buyer can take to ensure contract performance.

• Assumptions about cost reductions not being delivered by the supplier. As the main reason for outsourcing any activity is reduced cost there will be an automatic assumption made by buyers that the new service will be cheaper than that provided in-house. This relates back to the specification and whether a like for like comparison was made when constructing the business case for the move. Also, it is often assumed that the outsourcing contractor will enjoy scale economies, learning curve cost advantages and perhaps cheaper labour than the client. With TUPE legislation, it will very much depend on the nature of the business whether or not these advantages can be realised.

• Relationship breakdown. This may be due to differences in the cultures of the respective partners, for example an aggressive buyer and a laid back supplier are unlikely to survive together for very long.

It could also be the clash of personalities in the respective organisations. More likely, relationship breakdown will have some more direct cause in that the contracting organisation is consistently failing to deliver the service required.

• Inflexibility on the part of the buyer of the supplier. In any business relationship there will be times when flexibility is called for to deal with changing circumstances or deal with an emergency situation.

This may require either party to go beyond the letter of the original specification or contract to solve the particular problem or alleviate the situation in some way. This relies on a sound relationship and is unlikely to happen where the relationship has not been properly developed.

Any of the above THREE or other valid reasons (10 marks)

Stronger answers will not only identify three points but provide a clear explanation as to why each point could lead to failure.
(b)

**Ensuring that outsourcing contracts succeed:**

- Ensure that a proper and full business case is made before considering any of the options. Make sure that the in-house service cannot be improved from its current state.
- Prepare a detailed specification for the service involving those who will be directly in receipt of it.
- Conduct a thorough risk assessment of the process. Make sure that the activity being outsourced really is non-core.
- Cost the present system carefully based on what is actually achieved. This should be used as a basis for the financial case to be compared with the outsourcing contractor’s costs on a like-for-like basis.
- Calculate the payback period but bear in mind that this will involve a lot of estimation and a few assumptions.
- Establish a contract management system with regular review meetings; these must have top management support and participation.
- Make sure that a contingency plan exists.

Any five valid ways to avoid failure: 5 x 3 marks = (15 marks)
Stronger answers will contain more detail making a clear link between the issues they identify and how they can lead to outsourcing success.

CIPS study guide reference : Chapter 9, section 4, page 158 – 164