Level 6 Professional Diploma in Procurement and Supply

PD4 - Supply chain diligence

EXAM EXEMPLAR QUESTIONS

QUESTIONS AND INDICATIVE ANSWER CONTENT
QUESTIONS AND MARKING SCHEME

Q1 Learning outcome: 1.0

(a) Assess THREE sources of risk that can impact on the vulnerability of globalised supply chains.  

(b) Justify FIVE arguments in favour of local sourcing in preference to global sourcing.

Marking scheme

(a) Candidates will achieve a pass mark through producing answers that assess three sources of risk that can impact on the vulnerability of a globalised supply chain. Higher marks will be awarded to those candidates that provide a definition of vulnerability which can be described as the susceptibility to adverse events and trends. Candidates can also define risk which refers to the characteristics of the chance and impact of those events and trends. An organisation will be comparatively vulnerable when its resistance to a risk is low and where the risk will have a significant impact.

There are a number of authors that have produced work on risks and the vulnerability of supply chains. Stronger answers will justify arguments through referring to relevant authors. For example, Christopher and Peck assess five main categories:

- **Process risks**: although these are internal processes that are the sequence of value adding activities undertaken by an organisation, the organisation may rely on outsourced or subcontracted suppliers to undertake these activities. For example, global retailers may rely on suppliers based in the Far East for the manufacture of clothing, and there can be the risks of sourcing practices that contravene ethical standards.

- **Control risks**: it is argued that controls are the assumptions, rules, systems and procedures that govern the workings of an organisation. Control risks that are applied to the supply chain can include relationship issues, capacity, inventory, demand and logistics. The failure of controlling these key aspects of supply management can cause disruption in supply chains.

- **Supply risks**: the risk associated with global suppliers being unable to produce requirements such as not achieving the required levels of quality or non compliance to specifications.

- **Demand risks**: variability in demand can create difficult market conditions which purchasers and suppliers may be unable to meet high demand, and be left with excess inventory or resources for times of low demand.

- **Environmental risks**: these can be unmanageable and remote such as earthquakes, outbreaks of terrorism or other civil unrest. It can be difficult to forecast these events but it can be possible to plan for such events. It is possible to assess other risks that can be made relevant to answer this question.
(b) This question requires candidates to justify five arguments for local sourcing in favour of global sourcing. It is important for candidates to demonstrate the reasoning of each point made. Each of the five arguments are worth 2 marks each.

Higher marks are awarded to those candidates that provide a robust justification of each point made.

Answers can include discussion of:
- Shorter supply chains are likely to be more agile and so more responsive to meeting customer requirements.
- There is likely to be an improved carbon footprint and so there will generally be better standards of sustainability.
- The sourcing process should be cheaper to create and to manage especially in situations where it may be difficult to obtain detailed information such as through carrying out a site visit.
- Generally lower transaction costs which will be achieved as a result of easier documentation since there are many restrictions in importing on a global basis.
- Transportation costs should generally be lower as well as simpler logistics such as packaging, insurance and fuel costs.
- Currency exchange rate risks can be avoided providing more certainty of pricing arrangements and payment. The imposition of tariffs and other barriers to trade will be avoided.
- Better control of trade secrets and intellectual property since the monitoring of any breaches of these should be easier to encounter.
- Simpler language and cultural compatibility which will impact on all stages of the procurement process.

Higher grade marks will be awarded to candidates that provide clear justifications of each argument.

(10 marks)

CIPS study guide references: (a) Pages 1, 4 and 7
(b) Pages 44 - 49
Q2 Learning outcome: 2.0

(a) Assess FIVE examples of anti-competitive agreements that could arise in commercial dealings between organisations.

(15 marks)

(b) Review the main approaches to the regulation of anti competitive agreements.

(10 marks)

Marking scheme

(a) The question requires candidates to assess five examples of anti competitive agreements that could arise in commercial dealings between organisations. These can be drawn, but not limited, to the following:

- **A cartel:** this refers to an agreement between organisations not to compete with each other. Such agreements may be kept secret and made informally between the organisations concerned. In other instances, these can be overt.

- **Bid rigging:** there can be an informal agreement between competitors on the pricing arrangements for tendering exercises. This can include ‘cover pricing’ where organisations may deliberately submit a high price so that other organisations in their network will have a higher probability of gaining the award of contracts.

- **Collaboration over purchasing:** different purchasing organisations may agree to exchange information on markets, prices, suppliers etc. to gain an unfair advantage in their commercial dealings with these suppliers.

- **Limits on production, capacity or customer allocation:** this practice can be made by competing companies to create conditions that artificially stifle competition and so customers ultimately are disadvantaged.

- **Market sharing and customer allocation:** competing organisations agree to share out markets, customers or sales territories. In effect, each organisation will agree to withdraw from a specific market.

- **Price fixing:** competitors agree to fix, align, or co-ordinate their prices or price increases, ranges, discounts or other related activities.

The assessment of each of the five examples of anti competitive agreements that could arise in commercial dealings between organisations is worth 3 marks each. Higher grade marks will be awarded to those candidates that are able to provide depth and breadth of discussion on each example.

(15 marks)
This question requires candidates to review the main approaches to the regulation of anti-competitive agreements. Answers that achieve the required standard can refer to the following points:

Risk based regulation: this form of regulation seeks to create standards or codes of practice to enforce duties by organisations. There are many examples of these such as the Ethical Trading Initiative for example.

**Legislation:** Many countries are subjected to legislative controls over anti-competitive practice such as those that apply throughout the European Union. EU laws govern competition concerning agreements, decisions of associations of undertakings and restrictive practices (Article 101) and abuses of a dominant position (Article 102), which are liable to be anticompetitive. If there is a breach of legislation, the European Commission has a number of powers to take decisions, to conduct investigations and to impose penalties. If the Commission finds that there has been an infringement of Article 101 or 102, it may order the organisations concerned to bring the infringement to an end.

The European Commission, for example, also has the right to:
Conduct sector inquiries: where the trend of trade between EU countries, the rigidity of prices, or other circumstances so that competition may be being restricted or distorted throughout Europe, the Commission is able to conduct an inquiry into a particular sector of the economy or into a particular type of agreement across various sectors. The Commission may impose fines on offending organisations of up to 10% of their total turnover. In fixing the amount of the fine, the Commission must take account of the gravity and the duration of the infringement. When a fine is imposed on an association of undertakings and the association is insolvent, the Commission may require payment from each of the undertakings which were members of the association at the time of the infringement. The financial liability of each undertaking may not exceed 10% of its total turnover in the preceding business year.

Higher grade marks will be awarded to those candidates that provide the breadth and depth of discussion on the main approaches to the regulation of anti-competitive agreements.

(10 marks)

CIPS study guide references: (a) Pages 77 - 80  
(b) Pages 74 - 76, 78 - 80
Q3  Learning outcome: 3.0

Currency management has become an increasingly important issue for many organisations as they become more dependent on purchasing goods and services on a global basis.

(a) Assess THREE main reasons for the volatility of exchange rates.  

(b) Compare the use of spot and forward exchange rates in the management of currencies by organisations in a supply chain.

Marking scheme

(a) This question requires candidates to assess three main reasons for the volatility of exchange rates. There are many reasons for the volatility of exchange rates and to achieve the required standard, candidates can draw their answers from the following points although other reasons can be made relevant to answer this question. Higher grade marks will be awarded to those candidates that provide a justification and a clear explanation on the reasons for the volatility in exchange rates.

Supply and demand: Like any commodity, the value of a currency rises and falls in response to the forces of supply and demand. Businesses and consumers need to spend, and consumer spending directly affects the money supply and so exchange rates are primarily driven by the supply and demand in foreign exchange markets.

The level of interest rates: Central banks and governments influence interest rates that regulate borrowing in an economy. Interest rates set the base rates for banks and other financial institutions to charge customers to borrow money. For instance, if the economy is under-performing, central banks may lower interest rates to make it cheaper to borrow; this often boosts consumer spending, which may help expand the economy.

Employment Outlook: Employment levels can usually have an immediate impact on economic growth. As unemployment increases, consumer spending falls because jobless workers have less money to spend on non-essentials. Those still employed tend to reduce their spending and save more of their income. An increase in unemployment signals a slowdown in the economy and a possible devaluation of a country’s currency because of declining confidence and lower demand.

Economic growth expectations: To meet the needs of a growing population, an economy must expand. An expanding economy will generally lead to a strengthening of their currency. However, if growth occurs too rapidly, the higher growth creates higher inflation, and this trend can weaken the country’s exchange rate. Deflation is the opposite of inflation; it occurs during times of recession and is a sign of economic stagnation and this can lead to a fall in the value of currency against stronger countries.

The balance of trade: A country's balance of trade is measured by the total value of its exports, minus the total value of its imports. If this number is positive, the country is said to have a favourable balance of trade. If the difference is negative, the country has a trade gap, or trade deficit. The trade balance then impacts on supply and demand for a currency.
**Central government intervention:** With interest rates in several major economies already very low (and set to stay that way for the time being), central bank and government officials are now resorting to other, less commonly used measures to directly intervene in the market and influence economic growth. For example, quantitative easing is being used to increase the money supply within an economy. It involves the purchase of government bonds and other assets from financial institutions to provide the banking system with additional liquidity.

\[(15 \text{ marks})\]

\[(b)\] This question focuses on a comparison of the use of spot and forward exchange rates in the management of currencies by organisations in a supply chain. To achieve a pass grade, to achieve a pass mark, it is necessary for candidates to provide an examination of both spot rates and forward contracts.

A spot rate is the exchange rate that is being offered at the current time for an immediate transaction. The spot foreign exchange (forex) rate differs from the forward rate in that it prices the value of currencies compared to foreign currencies today, rather than at some time in the future. The spot rate in forex currency trading is the rate that most traders use when trading with an online retail foreign exchange broker.

A currency futures or forward contract is a legally binding contract that obligates the two parties involved to trade a particular amount of a currency pair at a predetermined price (the stated exchange rate) at some point in the future. Assuming that the seller does not prematurely close out the position, they can either choose to own the currency at the time the future is written, or may speculate that the currency will be cheaper in the spot market some time before the settlement date. Higher grades will be awarded to candidates that offer a clear explanation of the use of currency options. These allow the right to buy or sell a specific exchange rate at a future date. A future option allows the option holder the right to either buy or sell a currency in the future depending on the movement of exchange rates.

\[(10 \text{ marks})\]

*CIPS study guide reference:* (a) Pages 208 – 209
(b) Pages 212 - 214
Q4  Learning outcome: 4.0

A recent report highlighted that the main measure of performance used by the majority of purchasing organisations was reduced costs.

Propose other sets of performance measures that could be applied by purchasing organisations to assess their contribution to corporate performance.

(25 marks)

Marking scheme

This question focuses on performance measures besides reduced costs that can be proposed by purchasing organisations to assess the contribution to corporate performance. To achieve a pass mark, candidates can create their proposals from the following points, although other arguments can be made relevant to answer this question.

Process based metrics: these will focus on the conversion of inputs into outputs. There are many processes that can impact on organisations in the field of procurement and supply. The different stages of the procurement process such as the time taken for tendering or competitions can be assessed, the volume of competition such as the number of suppliers that compete for work etc. can be measured. Many measures that are process orientated will measure the timescales achieved, such as the average length of a tendering process. Measures can also focus on quantities of completed transactions, the number of contracts concluded, the number of suppliers and the number of non-competed contracts etc. The measures of process capabilities will generally be geared around the achievement of quality, delivery and timescales as well as cost.

If the organisation holds inventories, there can be many measures of both inventory and service levels that have been achieved. Inventories may be separated into different categories such as cycle, safety and different types of work in progress including opening and closing. Higher grade marks will be awarded to candidates who propose service ratios that gauge the achievement of responses to customer requirements such as the number of returns, warranty claims and order completion such as on time in full, delivered in full on time etc.

Higher grade marks will be awarded to candidates that include discussion on escalating levels of measures. Writers such as Judson and Cross and Lynch have proposed performance pyramids which consist of different levels of performance measures.

The process based measures that calculate aspects of quality, delivery, time and cost are enforcing operational levels of measurement and form the foundations of the structure of a pyramid. At the top will be levels of measurement appropriate to the corporate level of the organisation and its supply chain. There can be measures here that are geared in private sector organisations to the achievement of profitability as well as market share and growth. The second level will generally include measures of business unit performance. The middle strata will typically be constituted by measures of customer satisfaction, flexibility and productivity.

Equally, higher grade marks will be awarded to candidates that propose the use of balanced scorecard methodologies to assess the contribution to corporate performance. Writers such as Kaplan and Norton developed such a methodology. Like the performance pyramid, it was developed to provide a comprehensive framework that translates an organisation’s strategic objectives into a set of performance measures. The scorecard considers organisational performance from four viewpoints, the customer perspective (so measures of the number of preferred suppliers, new products/services, key accounts etc. would be relevant in this area of the scorecard). Secondly, internal business perspective can include measures of productivity, cycle times and other sources of efficiency. A third set of measures focus on innovation and learning. In this area, Kaplan and Norton emphasise
that ‘learning’ is more than ‘training’; it also includes things like mentors and tutors within the organisation, as well as the ease of communication among workers that allows them to readily get help on a problem when it is needed.

The cost of supplies would be included in the final category which measures financial performance.  

(25 marks)

CIPS study guide reference: Pages 269 - 278