

CHAPTER 3

Supplier Selection Criteria

Assessment criterion and indicative content

- 1.3** Define selection criteria that can be commonly applied when sourcing requirements from external suppliers
- Typical selection criteria such as: quality assurance, environmental and sustainability, technical capabilities, systems capabilities, labour standards, financial capabilities and credit rating agencies
 - The importance of supplier financial stability and due diligence checks
 - Ratio analysis to make conclusions on profitability, liquidity, gearing and investment
 - The limitations of ratio analysis

Section headings

- 1 Supplier selection and appraisal
- 2 Quality assurance
- 3 Environmental or sustainability criteria
- 4 Technical and systems capabilities
- 5 Financial capabilities and credit rating
- 6 Financial stability and due diligence
- 7 Financial ratio analysis

Introduction

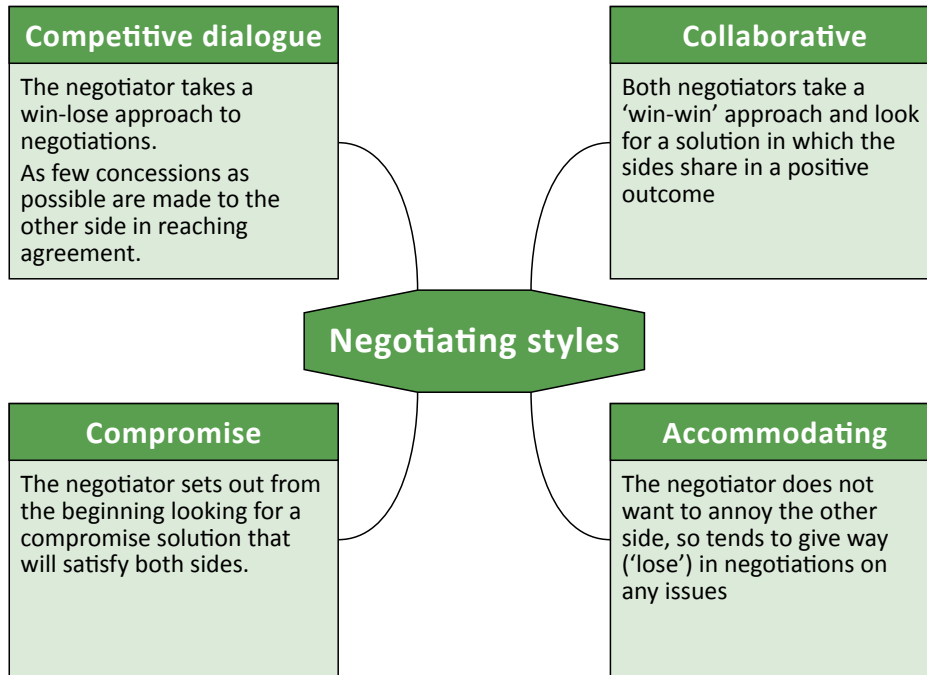
In this chapter we look at criteria that are commonly used when making decisions about sourcing from external suppliers, and whether or not to use a particular supplier, for example whether or not to include a supplier in a pre-approved list of suppliers.

We need to make a distinction between criteria used for supplier selection (or supplier pre-qualification) and criteria used for the award of specific individual contracts. In this chapter, we focus on supplier approval (pre-approval) rather than on individual procurement contracts.

3.2 Negotiating styles

The individuals who negotiate the terms of a contract for a buyer or seller will adopt a particular approach, or negotiating style. The various negotiating styles that might be used are set out in Figure 2.3

Figure 2.3 Direct negotiations with suppliers: negotiating styles



3.3 Stages in negotiations

There are four broad stages in negotiations between a buyer and a supplier on the terms of a supply contract. These are set out in Table 2.7.

Table 2.7 Stages in negotiations between buyer and supplier

STAGE	WHAT IS INVOLVED?
1 Preparation	Identify issues on which negotiation may be required. Decide the 'ideal' outcome for each issue. Rank issues as high, medium and low priority. Decide what concessions can be made if required. Decide what concessions should not be made.
2 Exchange of information	Buyer and supplier exchange details of issues they need to discuss. The supplier provides details to the buyer of the issues it wants to discuss and the outcome it would like. The buyer provides details to the supplier of the issues it wants to discuss and the outcome it would like. This exchange of information should ideally take place before face-to-face negotiations begin, so that each side is aware of what should be discussed, and can prepare a response to each issue in advance.

Chapter summary

- Organisations with ethical policies should monitor ethical behaviour continually, in their own organisation and in their supply chain.
- Employees should be encouraged to report suspicions of unethical behaviour, through their line manager or (if appropriate) through a whistleblowing procedure.
- Monitoring of ethical standards in a supplier's workplace may be achieved through ongoing dialogue, the use of KPIs, visits to the supplier's premises or possibly an ethics audit.
- An ethics audit investigates whether an organisation is meeting an established standard for ethical behaviour in the workplace, such as compliance with an ethics code, a contractual undertaking or specific internal control procedures.
- Dialogue with regular suppliers about making improvements in ethical behaviour should be constructive and an ongoing process.
- When an organisation discovers failings or a weakness in ethical standards in a supplier organisation or its supply chain, or in operational dealings with the organisation itself, the cause of the problem should be identified and a remedy agreed.
- Conflict of interest is a potential ethical problem in dealings between an organisation and a supplier, often due to close family connections or the use of gifts and hospitality (personal self-interest).
- Measures to address the risk of conflicts of interest include rules on competitive bidding, rules on accepting gifts or hospitality, declarations of 'no conflict of interest', and code of ethics rules.



Self-test questions

Numbers in brackets refer to the sections, tables or figures where you can check your answers.

- 1 In what ways might an organisation monitor ethical standards in a supplier organisation? (1.3)
- 2 How might an organisation deal with an allegation of unethical behaviour by a supplier? (1.4)
- 3 What might an ethics audit investigate? (2.2)
- 4 What are the stages or steps in conducting an ethics audit? (3.1, Figure 13.1)
- 5 What records might be kept of measures to deal with a weakness in ethical standards and implement a remedy? (5.3, Table 13.2)
- 6 What are the main reasons why conflicts of interest arise in procurement? (6.1)
- 7 What measures might be taken to address the risk of conflicts of interest in procurement? (6.4)

Now attempt Questions 37–39 from Chapter 15.

27	B and C	Product safety standards are often included in regulations, for example in food safety regulations. Anti-cartel legislation is aimed at preventing suppliers from collaborating to gain an advantage over buyers. International product standards and quality management standards are voluntary, not regulatory requirements. Public sector procurement regulations do not apply to buyers in the private sector.
28	B	DDP requires the supplier to deliver the goods to a location in the buyer's country, and to accept responsibility for transportation (including customs clearance) for the entire distance. This places the greatest responsibility for transportation on the supplier and the least responsibility on the buyer.
29	C	Credit risk is the risk of non-payment. Obtaining payment in advance has the least credit risk for the exporter, but means that the buyer faces the risk of non-performance of the contract by the supplier.
30	D	FOB and CIF are used only for shipments by sea, and not by air. Incoterms beginning with the letter C must specify a destination in the importer's country. DAT is the only incoterm from the four listed that might be used.
31	C and E	Forced labour, bonded labour, human trafficking and child slavery are all examples of modern slavery. Organisations such as the ILO seek to eliminate or regulate child labour, but this is not considered modern slavery.
32	D	The OECD encourages governments to legislate to criminalise (not just 'restrict') bribery of foreign officials. It encourages companies to restrict the use of small facilitation payments (in its 'Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions'). Fraud and modern slavery are not subjects that are dealt with by OECD conventions or recommendations.
33	A	SA 8000 certification is evidence of compliance with the SA 8000 standard, which in turn is based on ILO Conventions and Standards and the UN's Universal Declaration of Human Rights. Companies in Europe do not subscribe to the European Convention on Human Rights.
34	A	A close social connection can influence an individual's business decisions, so a potential conflict of interest does exist. Tom should report this to his line manager, who should remove him from the procurement process for the equipment. This is to comply with the CIPS Code of Conduct.
35	C	Answers to questionnaires are provided by suppliers themselves, and so cannot necessarily be relied on without supporting (independent) evidence. CIPS members should encourage organisations with which they deal to comply with the CIPS Code, but this does not guarantee a supplier's ethical behaviour and respect for human rights of employees. A due diligence exercise, however, as part of a prequalification process in supplier selection, should provide independent evidence of a supplier's employment practices.
36	B	The right to make unannounced inspections of the supplier's premises enables the buyer to obtain its own evidence about the supplier's behaviour. The other measures do not do this.