



CIPS

A7

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An Introduction to Purchasing Strategy

Question & Answers

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**QUESTION: 1**

Which of the following is the main objective of vendor rating?

- A. To provide a measurement of performance of a contract
- B. To make sure that the lowest possible cost is achieved
- C. To reduce risk to both parties
- D. To achieve the highest possible quality.

**Answer: A**

**QUESTION: 2**

The main purpose of a PEST analysis is to identify which of the following?

- A. The strengths and capabilities of an organisation
- B. The weaknesses of an organisation
- C. The core competences of an organisation
- D. The opportunities and threats presented by the external environment.

**Answer: D**

**QUESTION: 3**

Which of the following, according to Porter, is an area for concern in identifying the competitive position of an organisation?

- A. Economic environment
- B. Product life cycle analysis
- C. The extent of rivalry in a market
- D. Comparative earned value analysis.

**Answer: C**

**QUESTION: 4**

'Bottleneck' items in the supply positioning model are best described by which of the following?

- A. Important purchases that are made in a market where there are many suppliers but where the value is high
- B. Important purchases made in a market where there are few suppliers and the value is low

- C. Important purchases made in a market where there are few suppliers but the value is high
- D. Important purchases made in a market where there are many suppliers and the value is low.

**Answer: B**

**QUESTION: 5**

Which of the following would be most likely to support a successful strategy of narrow differentiation for an organisation?

- A. Offering a standardised product produced at a very low cost
- B. Offering a standardised product where the brand name had been heavily promoted
- C. Offering a non-standardised product to satisfy the particular needs of a small market segment
- D. Offering a non-standardised product to cater for the needs of a wide market segment.

**Answer: C**

**QUESTION: 6**

Which of the following best describes a strategy of 'related diversification'?

- A. Marketing an existing product in an existing market
- B. Marketing a new product in an existing market
- C. Marketing a new product in a new market
- D. Marketing an existing product in a new market.

**Answer: C**

**QUESTION: 7**

Which of the following tools of analysis is most suited to establishing the targets for an internal cost reduction programme?

- A. Pareto analysis
- B. Value chain analysis
- C. Porter's 'five forces' analysis
- D. Ansoff's analysis.

**Answer: A**

**QUESTION: 8**

Which of the following best categorises the following definition: 'A way of managing an organisation so that every job, every process, is carried out right, first time, every time??'

- A. BS 5750
- B. ISO 9000
- C. TQM
- D. FMEA.

**Answer: C**

**QUESTION: 9**

Which of the following might be best included in a definition of corporate strategy?

- A. Decisions that will affect the scope of an organisations' activities
- B. Decisions that will concern only a few areas of an organisation
- C. Decisions that will affect only one area of an organisation
- D. Decisions that will have very little impact on any area of an organisation.

**Answer: A**

**QUESTION: 10**

Which of the following is the main focus for purchasing operations in an organisation pursuing a strategy of cost leadership?

- A. The sourcing of very high quality specialist items
- B. The sourcing of inexpensive standardised products
- C. The sourcing of inexpensive non-standardised products
- D. The sourcing of very low quality non-specialist items.

**Answer: B**

**QUESTION: 11**

Explain how organisations match activities and resources to achieve competitive advantage.

**Answer:**

Answers should have focused on the need to match resources to activities. This is critical for any organisation since if these are not in balance, there is a high risk of failure. For full marks, candidates should have mentioned that organisations must analyse both the internal and macro-environmental situation in order to balance resources and activities against these constantly changing variables. Some candidates failed to answer this question, others did not mention the need to match activities and resources at all, and some simply listed resources or activities of an organisation without drawing any linkage.

**QUESTION: 12**

One of the important stages of strategy formation is the analysis of the organisation's environment. Outline TWO techniques that may be used for this purpose.

**Answer:**

Answers should have described two tools from PEST (Political, Economic, Social, Technical) or SLEPT, SWOT (Strengths, Weaknesses, Opportunities, Threats), Porter's 5-Force Analysis (threat of entrants, power of buyers and suppliers, threat of substitutes and competitive rivalry). However, merely listing the title of these tools (PEST or 5-Forces) in isolation was not sufficient to generate full marks. Fuller explanations behind what these tools actually comprise and/or where they could be typically used generated full marks.

**QUESTION: 13**

- (a) Name THREE direct functions of a business organisation.
- (b) Name TWO indirect functions of a business organisation.

**Answer:**

Direct Functions include Production, Purchasing (though in some organisations this can be indirect) Marketing and Sales, Distribution and Indirect are more supportive (for example Finance, Research and Development, HR, IT, Tax. Some candidates became confused around which functions were Direct and which were Indirect. Within a matrix style of organisation, typically Indirect functions support the various Direct Functions. Another distinction would be that Direct functions tend to have a bottom-line impact on profitability (that is, production costs, purchasing costs or sales volumes achieved) as opposed to Indirect functions which contribute general overhead to the organisation.

**QUESTION: 14**

Outline FIVE consequences of quality defects.

**Answer:**

This question required candidates to list five consequences of poor quality or quality defects. Such listings would typically include cost of scrapping non-compliant materials, cost of re-working or recycling on processes, time and production delays, inability to operate just-in-time processes, loss of goodwill and reputation with customers and other internal stakeholders, loss of potential revenue (that is, the opportunity cost that could

have been spent elsewhere has to go on curing quality issues). Most candidates scored very well in this question and had a good appreciation of the typical issues and costs. More explanation of the points, however, as opposed to pure bullet point listing, should be encouraged.

**QUESTION: 15**

Construct a diagram showing FIVE stages in a typical supply chain.

**Answer:**

This question would ideally be set-out in a diagrammatic format and should have described a typical supply chain such as follows: Most candidates correctly explained five stages of a typical supply chain. Strong answers also highlighted that supply chains are circular and will often vary depending on industry or the nature of what is being produced. For example, in the Goodvibes case study (question 19), we see a slightly longer supply chain due to the specialist nature of some components that are being produced).

**QUESTION: 16**

State FIVE costs affecting purchasing that result from product diversity.

**Answer:**

In this question, candidates were asked to state five costs of product diversity. However, answering this question depended on knowledge of what product diversity is (that is, a proliferation or large number of different products being produced and marketed). Typical costs included: - Greater sourcing workload on buyers (resulting in more contracts to procure, maintain and manage and a larger supply base being required) - Maintenance costs are higher (since there are possibly more production facilities to maintain) - Training costs are much higher (sales force and production operatives need to be trained on multiple products, systems and production techniques) - Processing or production costs increase (since there is likely to be more set-up/down time encountered by the need to schedule different production runs) - Less aggregation of demand (due to offering wider ranges of product to the market) will lead to higher unit costs and ultimately less negotiation leverage with the supply base. General performance on this question was good and most candidates understood that corporate decisions on which products and how many are offered to the market (that is, the relative degree of product diversity) will have direct knock-on consequences to purchasing, production, sales functions, and so on.

**QUESTION: 17**

- (a) Describe an appropriate process that an organisation could use to reduce its supply base.
- (b) State FIVE benefits of supply base rationalisation.

**Answer:**

Part (a) required candidates to outline an appropriate process that a company could use to reduce its supplier base. The clue to answering this question was the term "Process". Part (b) was more straightforward simply requiring five benefits of doing this. Within part (a) answers should have focused on a brief description of what supplier reduction actually is. Many candidates related supply base reduction to supplier rationalisation which was a good parallel to draw ready for the second part of the question. In terms of process steps, within a good answer, candidates discussed Pareto analysis or else other similar type of spend analysis which would reveal that a smaller number of suppliers (20% in Pareto) typically represent 80% of the spend and hence this analysis is always a good starting point for any supplier reduction exercise. Another part of the process could then be to segment the smaller number of suppliers into the supplier positioning model (Critical, Routine, Bottleneck, Leverage) in order to evaluate which of those suppliers are really critical to the organisation's success. The third part of the answer should have focused around the need to develop appropriate strategies for the 20% of key suppliers as well as what to do with the remaining 80%. For example, the need to develop closer working relationships with critical suppliers and the need to reduce and leverage routine suppliers. Connecting all of the steps above into a process generated good marks, as did the recognition this process should be constant, not a one-off exercise. For part (b) the benefits of supplier rationalisation could have included - Aggregation of spend/demand among fewer suppliers (leading to economies of scale/savings opportunities) - Improved vendor rating activities (due to fewer more critical relationships being maintained) - Closer relationships being developed with critical and bottleneck suppliers (leading to quicker resolution of issues/problems as well as opportunities to deliver cost savings - Lower administrative costs (due to less suppliers/contracts being maintained) - Time saved by buyers can be strategically used to work on supply chain integration activities.

**QUESTION: 18**

The design department of Mouse-It, a light engineering company, has developed a new mousetrap for a growing number of households that are reluctant to kill or injure mice for ethical reasons. The new mousetrap consists of a tube, both to locate the bait (mice prefer chocolate to cheese), and also to contain the mouse and prevent its escape until it is relocated by the householder. The unique selling point of this development is that it saves the householder from either walking or driving a long distance to release the mouse as it is well known that mice will return to their territory. Highly sophisticated devices incorporated by the design team not only restrain the mouse but also disorientate it to such an extent that it will happily establish new territory very close to the release site. These devices are very expensive and the marketing department reports that, however revolutionary and innovative the product might be, there is simply no market for it.

**TASKS**

- (a) Outline THREE reasons for early involvement of the purchasing function in the development of the new mousetrap.
- (b) If it is decided that a value analysis exercise is to be conducted on the new mousetrap, state FOUR business functions that should be represented.
- (c) Explain how the purchasing department may help reduce the cost to make the product in order to make it more marketable.

**Answer:**

Purpose of part (a) was to encourage candidates to consider the value of involving purchasing early on in the process of product development. Answers should have referenced points such as providing advice on: - Strategies for procurement: Should they competitively tender the requirement or negotiate with the existing supplier base - Sources of material/services and alternatives: Purchasing departments should have data on possible sources, engage with the marketplace in order to identify new/potential providers as well as keeping up to date with innovations and new developments such as alternative materials. A database on capabilities/competence of potential contractors would normally be maintained. - Standardisation/Cost Reduction Opportunities: Purchasing should be able to advise on opportunities to buy generic items, as opposed to paying premium prices for highly engineered/proprietary products/services.

- Logistical Issues/Supply difficulties : Purchasing should be looking at end-to-end supply chain issues such as lead-time, logistics issues, such as transport, and any macro-environmental factors (strikes, legal issues, and so on) which could impact on the project - Costs of materials and services: To solicit cost quotations, undertake tender exercises, compare bids and make award recommendations.

In part (b) the question is designed to ensure that candidates recognise other functions which need to be integral parts of a cross-functional value analysis team to include production, purchasing, finance, marketing and sales. The bulk of the marks, however, were available in part (c) for explanation of how purchasers can add value and reduce the cost of the product in order to increase its commercial marketability. In particular, candidates should have picked out the potential of purchasing coordinating value analysis and value engineering/cost reduction activities via the cross-functional team identified in part (b) above. Such activities would involve looking in detail at specifications and considering whether materials/components could be sourced at lower costs (perhaps by bundling/aggregating demand), investigating alternative sources (for example, low cost country sourcing) or implementing/trialling standard/generic components as opposed to bespoke/tailor-made products (which would in turn bring down cost). Other answers also included adding additional features/benefits at no additional cost in order to differentiate the product in the market and thus justify higher prices. As part of the cross-functional team, purchasers could also invite supplier involvement into the value-engineering initiative.

**QUESTION: 19**

Goodvibes plc designs engineering solutions and equipment for the construction and civil engineering industry worldwide. It is particularly concerned about supply problems occurring in the concrete machinery division of the company. These problems are causing a serious loss of customer confidence. The root of the problem lies with one of products made and sold by the Goodvibes - a vibrator that is used to settle and compact newly poured concrete. These vibrators are made from a number of precision engineered components that have to withstand, not only those stresses resulting from the function inherent in the task they perform, but also the frequent abuse received from the often untrained operatives using them. One particular component, the outer casing of the vibrator, often fails because of the inadequacy of the heat treatment process used to harden it. This process is critical. Not only has the temperature to be within narrow

tolerance limits, but the time the component is subjected to that temperature is also critical. Comfrey is a long-established, and normally very reliable company that supplies the casing and subcontracts the specialised, but low cost, heat treatment work. Aware of the problem, Comfrey has already tried to source the work elsewhere, but without success. Many companies throughout the world provide heat treatment services but apparently few have the capability of meeting Goodvibes' specific standards. TASKS (a) Construct a diagram of the supply positioning model and locate on it the supply position between Comfrey and its subcontractor, the heat treatment company. (b) State FOUR general solutions to dealing with purchases located within the category identified in your answer to part (a). (c) Explain the practical steps Goodvibes should take in an attempt to resolve its supply chain problem.

**Answer:**

Construct a diagram of the supply positioning model and locate on it the supply position between Comfrey and its subcontractor, the heat treatment company. State FOUR general solutions to dealing with purchases located within the category identified in your answer to part (a).

**QUESTION: 20**

State FIVE costs affecting purchasing that result from product diversity.

**Answer:**

In this question, candidates were asked to state five costs of product diversity. However, answering this question depended on knowledge of what product diversity is (that is, a proliferation or large number of different products being produced and marketed). Typical costs included: - Greater sourcing workload on buyers (resulting in more contracts to procure, maintain and manage and a larger supply base being required) - Maintenance costs are higher (since there are possibly more production facilities to maintain) - Training costs are much higher (sales force and production operatives need to be trained on multiple products, systems and production techniques) - Processing or production costs increase (since there is likely to be more set-up/down time encountered by the need to schedule different production runs) - Less aggregation of demand (due to offering wider ranges of product to the market) will lead to higher unit costs and ultimately less negotiation leverage with the supply base. General performance on this question was good and most candidates understood that corporate decisions on which products and how many are offered to the market (that is, the relative degree of product diversity) will have direct knock-on consequences to purchasing, production, sales functions, and so on.