

PROCUREMENT

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## 1995 KEY AREA PAPER: PURCHASING/PROCUREMENT

The purchasing environment facing BATCo has changed dramatically during the last 12 months. BATCo is now purchasing in an environment that has the following issues:-

1. Substantially rising commodity prices - e.g. woodpulp prices rising from \$350/tonne to estimated levels of over \$1000/tonne
2. Suppliers in a position where demand exceeds supply from their production
3. A hardening of the marketplace and the suppliers' approach due to 1 and 2 above.

In this environment the strategy for 1995 will be :-

1. Continue to have security of supply as the primary imperative
2. Ensure the continuity and development of the quality of our suppliers
3. Reduce the Total Acquisition Costs of our purchases.

In addition to this, three further areas will be developed :-

1. To gain a closer relationship with core suppliers in order to have a proactive innovation between BATCo and its suppliers
2. To have suppliers committed to support of BATCo in the re-socialisation of smoking
3. The identification and development of BATCo people to achieve this.

Within the context of the above, the following have been identified as Purchasing/Procurement Primary Objectives:

1. To ensure that, within the bounds of commercial viability the highest available levels of security, quality and consistency of materials are used on our key brands, particularly International Brands.
2. To reduce BATCo's materials spend in real terms against the market, throughout the plan period by taking advantage of BATCo's and BAT Industries annual material purchasing volumes.
3. To ensure that materials used minimise total cost - taking into account all costs incurred - ie purchase price, overhead costs, delivery, packing, storage, finance, import duties, machine performance and actual material wastage.
4. To understand the current level of competence of BATCo Procurement people against world class standards and develop a change programme to achieve this standard.
5. To review purchasing of items other than wrapping materials that may offer Group wide benefit if volumes or negotiations are co-ordinated and in order to perform this to develop a system to collect and manage appropriate data across BAT.

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6. To ensure that materials used meet all established criteria and guidelines laid down by the Additives and Materials Guidance panel regarding Health and Safety of our workforce, our neighbours and our customers and that their manufacture, packing, use or disposal is in line with BAT's Environmental policies and guidelines.

Specific strategies to achieve the above include:

- a) In conjunction with the IBG, to develop, implement and monitor comprehensive Packaging Material Standards for each brand.
- b) To rationalise material specifications used throughout the Group without detriment to product quality, design flexibility or manufacturing efficiency, thereafter to fully document agreed specifications.
- c) To rationalise BAT's suppliers for key materials worldwide in order to focus our purchasing power with quality suppliers who are able to support our long term growth and development.
- d) To use selected suppliers where practicable to be the sole source of particular materials to individual manufacturing locations eg Single sourcing of tow to any one company to improve logistics and stockholding.
- e) To identify the structure and personnel involved in all procurement worldwide and from this group to manage an assesemnt and development programme to achieve 'best-in-class' standards.
- f) To review, select and implement an appropriate Procurement/ Purchasing/Order Processing system capable of worldwide implementation to support the above.
- g) To verify, where appropriate with Additive and Materials Guidance Panel (AMGP - based at BATCo Technology Centre, Southampton) and Group Environmental management, all materials that are used.
- h) To agree and implement a BAT Tobacco Group wide supplier rating system.

In order for the strategies noted above to be developed, BATCo has already initiated wrapping material, fertilisers/agrochemicals and vehicle surveys worldwide. The responses to these surveys are currently being reviewed. It is the intention, during 1995, that further Regional Purchasing Conferences be held to identify specific people, issues, suppliers and strategies appropriate to each region. In parallel with this, there are continued rationalisation projects underway for filter tow, cigarette paper, foil, tipping and board which should be available during 1995.

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Accordingly, it is recommended that:

- **Packaging Quality standards** for International Brands should continue to be verified to ensure conformance to international brand standards. Areas of doubt should be raised with IBG's or this department. Standards for local brands should be developed to mirror those of International Brand manuals. Rationalisation opportunities between brands should be sought to minimise stock items and cost eg Tear tapes, Tippings etc.
- All locally sourced materials in contact with our product should be confirmed as approved by AMGP and other materials must conform to local food and health legislation or, if not available or suitable, to US Food and Drug legislation.
- No new specifications or suppliers should be introduced for key materials sourced from international manufacturers without first discussing the proposal with this department.
- Current local suppliers of materials should be assessed by Operating Companies in terms of quality, service and cost. Local rankings should be developed to identify orders of preference. Alternative suppliers should be identified and investigated to determine suitability. Local material supplies should be reviewed to identify differences in quality, service or cost with current international standards.
- From this, sourcing strategies for local purchases should be identified by each Operating Company - identifying specification, suppliers, percentage split and reason for it; for the current year and the plan period. These should be discussed and agreed with local Production and Quality management. Within these strategies, the following should be considered:
  - Rationalisation of sources should be sought without compromising material availability.
  - Stock durations of materials should be reviewed to eliminate unnecessary buffer stock.
  - For locally sourced materials with established supply lines, internally held stock could be < 1 month.
  - Stock holding of internationally sourced materials should be reviewed with this department as possible common regional stock points may be created.
- For locally sourced/negotiated materials a full Supplier Costing Analysis should be developed by Operating Companies, if possible identifying:-
  - Raw material usage eg tonnes of board per million cartons, source and costs;
  - Conversion costs with breakdown into labour, energy, depreciation, wastage;

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- Support costs for administration overheads, stock financing, credit terms financing,
  - packaging, storage and freight;
  - Margin or profit.
- Negotiations with suppliers should always be supported by documentation to identify what objectives were set, justification for our stance, actual result achieved.

It is strongly recommended that negotiations with suppliers are attended by a minimum of two BAT personnel who are both fully briefed regarding strategy and negotiation tactics and have the necessary negotiation skills.

- **Negotiations must cover:**
  - Quality requirements and any improvements needed;
  - Volumes forecast and allowable variances;
  - Service levels eg lead times, supplier stockholding, quality information, deliveries scheduling and method, materials packaging;
  - Price and validity - ideally 1 year or longer, payment terms and interest rates, handling of currency movements if appropriate

NB Suppliers' prices and negotiations should always be based on ex-works or FOB with additional costs identified separately.

- **Negotiations by Operating Companies** should aim to reduce costs for our business in real terms ie inflation adjusted. Every opportunity should be sought to reduce costs jointly with our suppliers and to encourage them to undertake longer-term quality or service improvements and cost reduction programmes through investment or personnel changes.
- **Supplier relationships** - BATCo must aim for the highest possible business ethics and professionalism in all our dealings with suppliers. We should not allow suppliers to influence us through inappropriate gifts or entertainment. We should insist on absolute integrity and honesty from ourselves and the supplier regarding information about each other. We should never divulge their pricing to their competitors.

Where possible we should aim to establish long-term relationships with our supply base that allow continuity and awareness of each others needs and future requirements.

Historically, suppliers have taken the approach to organisations like ourselves of 'divide and conquer'. We must ensure that communication within our Group is sufficiently good to prevent this occurring and suppliers must be made aware of this and your adherence to defined corporate sourcing strategies.

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Local suppliers must not be allowed to hide behind barriers and tariffs which preclude competitive imports. They must be encouraged at every opportunity to compare themselves with current international standards.

Conversely, local suppliers who are competitive in quality, service and price may be of significant interest to other Group members and should be encouraged to contact this office after discussion.

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