Think Critically

1. What kinds of things do businesses buy?

2. List the six goals of procurement management.

3. Name some of the tools and sources that a purchasing manager uses to select the right quantity to buy.

4. Why is lead time an important concern in timing future purchases?

5. List the seven main factors in choosing a vendor.

6. What is a cash discount?

7. List four types of paperwork common to the purchasing process.

Uncle Bill, Inc.

Uncle Bill grew up in a suburban neighborhood in the 1950s, a time when it was not uncommon for families to have gardens in their backyards. When he was 12, Uncle Bill was given a small plot of his family's garden to tend. He started selling the fruits and vegetables that he produced to neighbors in his town. Uncle Bill liked earning his own money, but there was only so much that his neighbors could buy. Uncle Bill decided that, if he wanted to make more money, he needed more clients. So he began advertising his garden fruit and vegetables to individuals and businesses outside his neighborhood.

His advertising worked ... too well. Uncle Bill's business grew so quickly that he couldn't keep up with demand. His family's garden simply didn't have the capacity to produce the quantity of fruits and vegetables he needed to supply his clients, so he decided to purchase additional produce in order to fill his orders. Uncle Bill's father, who worked as a truck driver, helped his son find small farmers in more rural areas from whom he could purchase the fruits and vegetables he needed to keep his customers satisfied.

For the next several years, Uncle Bill slowly expanded his business re-selling the produce he purchased from local farms. By the time he was 25, he had acquired a number of grocery stores as clients, developed relationships with several farmers, and even purchased his own truck, which allowed him to pick up and deliver the produce from the farms to his clients.

However, Uncle Bill realized that too much of his money was going to pay for others to grow the produce-his family garden had been small, but at least he had kept more of the profits. He decided to buy one of the farms he used as a supplier and invest in additional land and equipment to build the farm's capacity for fruit and vegetable production. After a few years and a lot of hard work developing the farm he'd purchased, Uncle Bill was able to supply almost all of the produce he needed for his customers.

Through the process of purchasing and taking over a farm, Uncle Bill learned that he could cut some of the costs of running the farm if he produced his plants, instead of buying them from outside vendors. By taking the sprouts common to existing plants and developing his own plants, Uncle Bill was able to diversify his plant offerings to the point where he could cut out plant suppliers all together. He began growing all of his own plants.

Once again, Uncle Bill saw opportunity. He realized that people were willing to buy the seedlings and plants that his farm was now producing. It wasn't long before Uncle Bill had a lively nursery business of his own, and he developed this side of his business further when he bought out a local nursery competitor who was ready to retire.

During his time developing his produce and nursery operations, Uncle Bill had the opportunity to purchase some land with timber on it. He originally thought that he'd cut down the timber and make a profit by selling it to a lumber yard. However, Uncle Bill never turned down an opportunity to think creatively, and he decided to keep the timber, develop his own lumber yard, and use the wood to pursue a personal passion: designing and building outdoor furniture.

Uncle Bill already had retail outlets in place through his grocery store clients and nurseries. However, he realized that he could capture a greater share of the outdoor furniture market if he purchased a storefront. Uncle Bill leased a building and began selling his furniture direct to customers.

1. What were the businesses that Uncle Bill started?

2. How did Uncle Bill engage with the supply chain as an entrepreneur?

3. How does Uncle Bill's story demonstrate the concept of vertical integration?

4. What were the benefits of vertical integration to Uncle Bill's business?

5. Although the story focuses on Uncle Bill's success, what might be some of the risks of vertical integration? How might these risks have affected Uncle Bill negatively?

Vertical Integration of YOUR Business

Think about the business plans that you wrote….

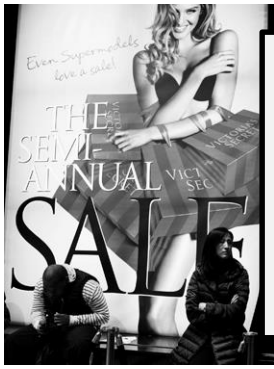
SUPPLY CHAIN: List the supply chain for your business … where do the raw materials for your goods/services come from?

VERTICAL INTEGRATION: Come up with a game plan for how you could vertically integrate your business so that you own the entire supply chain.

HORIZONTAL INTEGRATION: If vertical integration is starting/buying businesses who supply to you, what do you think horizontal integration means? Give an example of a business you could buy that would allow you to horizontally integrate.

The 10 Ways That Consumers Are Hopeless at Math

This is your brain on shopping, and it's not very smart



ASSIGNMENT

1. Read over this article.
2. Summarize each of the 10 ways that consumers are hopeless at math in **10 Bullet Points**.
3. Send this in an email.

You walk into a Starbucks and see two deals for a cup of coffee. The first deal offers 33% extra coffee. The second takes 33% off the regular price. What's the better deal?

"They're about equal!" you'd say, if you're like the students who participated in a new study published in the Journal of Marketing. And you'd be wrong. The deals appear to be equivalent, but in fact, a 33% discount is the same as a 50 percent increase in quantity. Math time: Let's say the standard coffee is $1 for 3 quarts ($0.33 per quart). The first deal gets you 4 quarts for $1 ($0.25 per quart) and the second gets you 3 quarts for 66 cents ($.22 per quart).

The upshot: Getting something extra "for free" feels better than getting the same for less. The applications of this simple fact are huge. Selling cereal? Don't talk up the discount. Talk how much bigger the box is! Selling a car? Skip the MPG conversion. Talk about all the extra miles.

There are two broad reasons why these kind of tricks work. First: Consumers don't know what the heck anything should cost, so we rely on parts of our brains that aren't strictly quantitative. Second: Although humans spend in numbered dollars, we make decisions based on clues and half-thinking that amount to innumeracy.

Here are 9 more ways consumers are bad at math, with an assist from historian and author William Poundstone.

(2) We're heavily influenced by the first number. You walk into a high-end store, let's say it's Hermès, and you see a $7,000 bag. "Haha, that's so stupid!" you tell your friend. "Seven grand for a bag!" Then you spot an awesome watch for $367. Compared to a Timex, that's wildly over-expensive. But compared to the $7,000 price tag you just put to memory, it's a steal. In this way, stores can massage or "anchor" your expectations for spending.

(3) We're terrified of extremes. We don't like feeling cheap, and we don't like feeling duped. Since we're not sure what things are worth, we shy away from prices that appear too high or too low. Stores can employ our bias for moderation against us. Here's a great story:

People were offered 2 kinds of beer: premium beer for $2.50 and bargain beer for $1.80. Around 80% chose the more expensive beer. Now a third beer was introduced, a super bargain beer for $1.60 in addition to the previous two. Now 80% bought the $1.80 beer and the rest $2.50 beer. Nobody bought the cheapest option.

Third time around, they removed the $1.60 beer and replaced with a super-premium $3.40 beer. Most people chose the $2.50 beer, a small number $1.80 beer and around 10% opted for the most expensive $3.40 beer.

In short: We are all Goldilocks.

(4) We're in love with stories. In his book Priceless, William Poundstone explains what happened when Williams-Sonoma added a $429 breadmaker next to their $279 model: Sales of the cheaper model doubled even though practically nobody bought the $429 machine. Lesson: If you can't sell a product, try putting something nearly identical, but twice as expensive, next to it. It'll make the first product look like a gotta-have-it bargain. One explanation for why this tactic works is that people like stories or justifications. Since it's terribly hard to know the true value of things, we need narratives to explain our decisions to ourselves. Price differences give us a story and a motive: The $279 breadmaker was, like, 40 percent cheaper than the other model -- we got a great deal! Good story.

(5) We do what we're told. Behavioral economists love experimenting in schools, where they've found that shining a light on fruit and placing a salad bar in the way of the candy makes kids eat more fruit and salad. But adults are equally susceptible to these simple games. Savvy restaurants, for example, design their menus to draw our eyes to the most profitable items by things as simple as pictures and boxes. Good rule of thumb: If you see a course on the menu that's highlighted, boxed, illustrated, or paired with a really expensive item, it's probably a high-margin

product that the restaurant hopes you'll see and consider.

(6) We let our emotions get the best of us. In a brilliant experiment from Poundstone's book, volunteers are offered a certain number of dollars out of $10. Offers seen as "unfair" ($1, let's say) activated the insula cortex, "which is otherwise triggered by pain and foul odors." When we feel like we're being ripped off, we literally feel disgusted -- even when it's a good deal. Poundstone equates this to the minibar experience. It's late, you're hungry, there's a Snickers right there, but you're so turned off by the price, that you starve yourself to avoid the feeling of being ripped off. The flip-side is that bargains literally make us feel good about ourselves. Even the most useless junk in the world is appealing if the price feels like a steal.

(7) We're pained by transaction costs... In a personal finance column here, Megan McArdle implored her readers to give up recurring payments like gym memberships and subscriptions to papers and services they don't use. "Don't buy stuff you don't consume" seems like obvious enough advice, but Megan had a great point. We're drawn to subscriptions and memberships and bundles partially because we seek to avoid transaction costs. We'd rather overpay a little than suffer the psychological pain of pulling out a wallet and watching our money go to each gym season/movie/etc.

(8) ... but we're weird about rebates and warranties. Now that I've just told you that consumers try to avoid additional payments, I should add that there are two additional payments we love: rebates and warranties. The first buys the illusion of wealth ("I'm being paid money to spend money!"). The second buys peace of mind ("Now I can own this thing forever without worrying about it!"). Both are basically tricks. "Instead of buying something and getting a rebate," Poundstone writes, "why not just pay a lower price in the first place?'

"[Warranties] make no rational sense," Harvard economist David Cutler told the Washington Post. "The implied probability that [a product] will break has to be substantially greater than the risk that you can't afford to fix it or replace it. If you're buying a $400 item, for the overwhelming number of consumers that level of spending is not a risk you need to insure under any circumstances."

(9) We're obsessed with the number 9. Up to 65 percent of all retail prices end in the number 9. Why? Everybody knows that $20 and $19.99 are the same thing. But the number 9 tells us something simple: This thing is discounted. This thing is cheap. This thing was priced by somebody who knows you like things discounted and cheap. In other words, 9 has transcended the status of charm price to become a cable of silent understanding between buyer and seller that a product is being priced competitively and fairly. Putting a 9 on a shell-fish platter at a high-end restaurant is ridiculous. Nobody spending $170 on lobster is looking for a discount. But the same person shopping for underwear is (research has shown, again and again) more likely to buy a product that ends in 9. Remember: Shopping is an attention game. Consumers aren't just hunting for products. They're hunting for clues that products are worth buying. In the number 9, the bargain-hunter/discount-gatherer corner of our brain spots a pluckable deal.

(10) We're compelled by a strong sense of fairness. I've already explained how our brains light up differently based on seeing a bargain vs. a rip-off. The shopper's brain is motivated by a sense of fairness. Again, it comes back to the idea that we don't know what things should cost, and so we use cues to tell us what we ought to pay for them. An experiment by the economist Dan Ariely tells the story beautifully. Ariely pretended he was giving a poetry recital. He told one group of students that the tickets cost money and another group that they would be paid to attend. Then he revealed to both groups that the recital was free. The first group was anxious to attend, believing they were getting something of value for free. The second group mostly declined, believing they were being forced to volunteer for the same event without compensation.

What's a poetry recital by a behavioral economist worth? The students had no idea. That's the point. I don't know, either. That's also the point. What's a button-up shirt "worth"? What's a cup of coffee "worth"? What's a life insurance policy "worth"? Who knows! Most of us don't. As a result, the shopping brain uses only what is knowable: visual clues, triggered emotions, comparisons, ratios, and a sense of bargain vs. rip-off. We're not stupid. Just susceptible.