Art of Procurement, in partnership with Ivalua

Collaborating with Suppliers to Blunt the Impact of Inflation

Procurement's priorities are driven by two separate but related sets of factors: internal business requirements and external market conditions.

Today's CPOs see budget constraints and managing supplier performance/supply assurance as the largest hurdles to procurement's success. Ardent Partners' research suggests that they even outrank technology challenges and stakeholder engagement[1].

Inflation is currently running at a four-decade high. It is also systemic and likely to be sustained for some time, potentially leading several countries into recession. As a result, procurement will have to manage budgetary constraints and supplier performance at the same time - potentially by leaning on one to solve the other.

In this paper, we will look at some of the challenges resulting from today's inflationary conditions and how working collaboratively with suppliers may open the door to operational efficiency and greater control over the supply chain.

Combating the Effects of Inflation at the Category Level

It is true that inflation can be perceived throughout the economy and across sectors, but it has to be addressed at a more granular level. For procurement teams, this likely means including inflation as one of the external factors included in category management strategies and tactics.

Before taking steps to address inflationary pressures, procurement should engage in company-wide communications. This will ensure that everyone is informed and has an opportunity to get involved so that the best strategies can be identified and acted upon.

[1] *Ivalua webinar, Top 10 CPO Metrics to Battle Inflation, Risk, and Uncertainty, September 1, 2022.*

© Procure Change LLC. All Rights Reserved.

When incumbent suppliers are in place, and they are already actively pursuing efforts to ensure their own operational efficiency, procurement can partner with those companies to manage and reconcile input costs. Generally speaking, packaging, materials, and transportation are all areas for consideration. Procurement may be able to help by leveraging their own, more advantageous pricing, or carefully alter the company's specifications and requirements to lower costs where the ROI does not justify spending more.

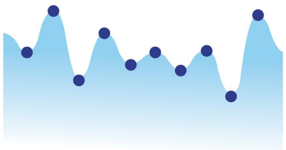
If there is more than one contracted supplier in a spend category, procurement has the option of reallocating volume to take advantage of the best pricing. Before doing so, procurement should review contract terms to make sure that no commitments are violated or less advantageous pricing structures invoked after a change in demand with any particular supplier.

If neither of these approaches work, procurement has the option to go back to market and bring in new suppliers with more competitive pricing - if any can be found - to help reduce cost pressures.

Regardless of which of the above approaches procurement decides to pursue, they should also build a should-cost model to benchmark the overall price for the product being purchased as well as impactful input costs and materials. In fact, where appropriate, the overall price of the item can be tied to a relevant commodity index. This will connect the price paid to changes in the market, whether it moves up or down, protecting the company against overpayment and suppliers against operating losses.

Before pursuing these strategies, procurement should ensure they have access to good data across the source-to-pay process and the ability to view all supplier activity in one place, as well as by category, item, plant, business unit, etc.

In challenging economic times, procurement should identify all options available to them before selecting the best path to follow.



Paying it Forward with Better Managed Working Capital

'Cash is king' as the saying goes, and this old adage is never truer than in inflationary times. When each dollar has to be stretched to the furthest, companies that have cash on hand can not only avoid paying higher rates for the debt they would otherwise have to carry, they can also use that cash to create an advantage for themselves in the marketplace.

When your company's cash position is strong relative to the market, you can be opportunistic about low price contracts, maxing out volumes or buying ahead. It may even be possible to further leverage that cash for lower prices with suppliers, paying sooner or up front in exchange for a lower effective price than is currently spelled out in the contract.

Be advised, however, that today's economy is as unpredictable as it is challenging. Many of the companies that invested in inventory to get themselves through supply chain disruption ended up regretting that choice when consumer demand changed and they were left with unwanted inventory that strained their cash position.

There are also ways to leverage working capital - others' working capital - when your own company's cash position is not as strong as you would like.

It is never a good idea to play games with contracted supplier payment terms, but following them to the letter may serve as a relief valve when there is shortage of cash. This is the right time to engage in active contract management, not just storing and indexing agreements, but invoking any terms or conditions that present an advantage or opportunity. This is especially true with longer term contracts, where a commitment has been made to the supplier. They benefit from that stability and should be willing to return the favor now if you have been a good and reliable customer partner.

© Procure Change LLC. All Rights Reserved.

The reverse is also true. When prices are high, driven up by external factors, procurement should look to sign shorter term contracts, balancing the administrative workload required on their part with the potential to secure more advantageous terms from the supplier(s) once economic conditions improve.

It is important to point out that leveraging cash on hand requires a great deal of nuance and understanding. Procurement should work closely with finance before considering any of these strategies. If you're not sure what the current working capital strategy is at your company, now is the time to reach out and have a conversation with finance, even if you have to rebuild a relationship bridge in order to do it.

Procurement's job isn't to bring all spend under management, but rather to influence 100% of spend.

Managing Inventory, Orders, and Demand

How a company consumes goods and services is just as critical as how they source and pay for them. In some cases, this includes spend categories that procurement has already secured contracts for, and in other cases it may be new needs identified by the business. Either way it should be clear when distributed buyers should reach out to procurement. Being as available as possible increases the likelihood that procurement will have the opportunity to intervene before resources are committed.

Not all spend can be competitively sourced by procurement, but that isn't a problem. In fact, all spend shouldn't be directly managed by procurement. There has to be either a certain level of risk or the potential for sufficient reward to justify starting up the 'procurement machine' for new spend. When a purchase is low in value or contained in scope, frameworks can be established for the business to handle the purchase themselves, checking in with legal, finance, or procurement as required.

© Procure Change LLC. All Rights Reserved.

When it does make sense for procurement to get involved, anything that can be done to make the process quick and easy for buyers will pay dividends. Not only does it increase the likelihood that the business will reach out, it improves the chances that they will reach out while there is still time for procurement to have the desired impact on cost by optimizing specifications and/or service levels, introducing alternate potential suppliers, and negotiating the best possible terms.

Whether procurement is directly involved in sourcing or not, everyone needs access to the information that might influence the timing and size of their purchases. Just as with household expenses, when each spender can see their purchase in the context of the needs and resources of the whole, their decisions improve.

Internal reporting should be conducted more frequently - ideally supported by automation rather than manual effort - and reports should be distributed as widely as possible from one central location.

Having visibility into budgets may even motivate budget holders to prioritize using what is on hand rather than purchasing something new. In our comments about working capital, we raised the possibility of buying ahead while guarding against the risk of being stuck holding unwanted stock. Product availability is a factor as well. If the risk of supply disruption is real and supported by data, running a lean or just-in-time inventory management program may turn out to be penny wise and pound foolish, leaving the company with plenty of working capital but no way of generating revenue or delivering against customer orders. Addressing this possibility is absolutely critical and should be done by a cross-functional team.

© Procure Change LLC. All Rights Reserved.

Conclusion

Working in an inflationary economy is no one's first choice, but since macro conditions are beyond the control of procurement and their suppliers, the best available option is often to collaborate and weather the storm together. If you already leverage a technology platform, hopefully it offers enough flexibility (workflows, business rules, analytics, etc) to implement some of the above recommended strategies quickly.

Being cautious and analytical will serve procurement well, and hopefully the company's key suppliers are similarly predisposed to take a thoughtful approach. If nothing else, challenging economic conditions present an opportunity for each company (and procurement team) to learn about themselves as well as the suppliers they have chosen to partner with.

About Ivalua

Ivalua is a leading provider of cloud-based Spend Management software. Our complete, unified platform empowers businesses to effectively manage all categories of spend and all suppliers, increasing profitability, improving ESG performance, lowering risk and improving employee productivity. We are trusted by hundreds of the world's most admired brands and recognized as a leader by Gartner and other analysts.

Learn more at **www.ivalua.com**. Follow us at **@Ivalua**.

About Art of Procurement

Art of Procurement was founded in 2015 to empower professionals at all levels to align procurement performance with corporate objectives. For more information, visit **www.artofprocurement.com**, follow the AOP company page on **LinkedIn** or follow us on **Twitter**.

© Procure Change LLC. All Rights Reserved.