

# Preparing the Company for Extreme Economic Volatility

By Laura Gibbons, Nicolas R. Walden and Christopher Sawchuk

## EXECUTIVE SUMMARY

The coronavirus pandemic is wreaking havoc in global supply chains, economies and the stock market. While its ultimate economic ramifications are unknowable at present, immediate observations include potential economic demand shock and expectations of a recession. Over half of procurement respondents to our 2020 Key Issues Study have already adjusted budgets, developed recession contingency plans or both. One thing is certain: We are in for a protracted period of volatility. It is therefore imperative that CPOs take steps to help insulate their companies from the effects of instability.

## INCREASING THE ALERT LEVEL

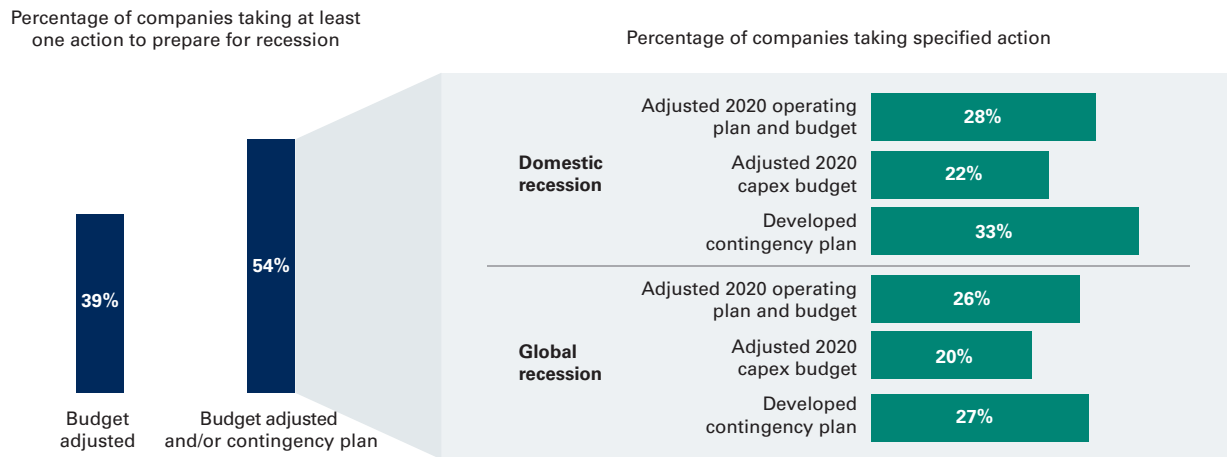
By the first six weeks of 2020, worries about an imminent recession had somewhat abated. Market consensus put the chances at around 30%. But suddenly, after an unprecedented run, the financial markets quickly gave up their gains – and more – due to concerns about the potential economic impact of a coronavirus pandemic. Uncertainty in trading relationships and the outcome of the upcoming U.S. presidential election have also been a source of worry for businesses.

The already severe impact of Covid-19 on businesses has supply management organizations heavily focused on managing the supply chain and reacting to new shocks appearing almost daily at this point. By the start of 2020, 54% of procurement respondents to our 2020 Key Issues Study reported they had adjusted budgets, developed recession contingency plans or both (**Fig. 1** on next page).

While it is comforting to know that procurement executives are alert to the threat of disruptive economic events and were already taking steps to prepare, it is also important to remember that cost reduction and contingency plans can backfire if they end up hurting long-term sustainability. So, executives must tread lightly.

Procurement is uniquely positioned to influence and control external spend across the organization, which commonly accounts for the largest expenditure outside of payroll. The traditional approach of arbitrary cost elimination through mass layoffs can hollow out a company's capacity to react to sudden changes in supply market conditions as well as capitalize on growth opportunities. Procurement should be encouraged to utilize its core bargaining and negotiation skills to provide additional cost savings, demand management, value generation and cash conservation.

FIG. 1 Recession preparedness



Source: Key Issues Study, The Hackett Group, 2020

## DOUBLING DOWN ON BEST PRACTICES IN TIMES OF ECONOMIC VOLATILITY

To prepare for further slowing of growth and a continuing volatility in the economic environment, procurement organizations need to accelerate their adoption of best practices to excise cost from inefficient processes without a loss of agility. Many of these practices are already part of the DNA of healthy procurement organizations. Less-advanced functions must catch up fast. Suggestions are as follows.

### Short-term steps to address supply concerns

#### 1. Plan for worst-case scenarios

Increase safety-stock levels (where available) to allow for supply shortages to take place without a massive impact to the business. For services, delivery flexibility or contingency plans may need to be activated. Understand which items being sourced are likely to be delayed or even unavailable and develop reserves or put contingency plans in place to allow for quick switches to secondary sources. Identify non-critical categories where purchases can be temporarily reduce or suspended should a spend reduction be required.

#### 2. Line up alternate sources if current suppliers are in high-risk locations

Procurement's most obvious concern is that of supply risk. The best approach includes maintaining open lines of communications with suppliers, monitoring critical suppliers, and mapping suppliers to identify those

located in high-risk geographies in order to understand the extent of the potential problem. For suppliers in problematic areas, line up alternate supply sources and speed up the introduction of new suppliers. To prepare, create a robust and agile risk management program, ensure secondary supply sources for critical goods and services, and develop a quick, user-friendly supplier onboarding program.

### 3. Conduct intelligent cost reduction

When demand plummets, there is a natural tendency to slash cost through company-wide capital, operating budget and headcount reductions. But such knee-jerk reactions can hurt the company's ability to compete, because it might stop work on profitable projects and reduce its ability to gain from new market opportunities. Leverage supplier relationships to discuss how external cost can be reduced, not just through price or terms, but also with ideas like adopting alternative products, or reengineering processes and practices.

### Long-term steps to address supply concerns

#### 4. Adopt an agile planning mindset

In 2008, a liquidity crunch and a sharp drop in economic activity took many by surprise. Companies had to toss out annual plans and scramble to come up with new strategies. Procurement scrambled to recover from supply chain shortages and order fulfillment issues. In 2020, as an example, a number of major airlines have reacted quickly to evaporating

customer demand through temporarily grounding planes and rationalizing routes to match customer demand. Leading procurement organizations are now similarly structured to be more agile: they anticipate and predict changing market conditions, price fluctuations or labor shortages; they conduct ongoing risk planning of key suppliers based on internal and external data; and deliver quick but well-thought-out responses to market disruption, supply shortages, new government regulations or tariffs.

#### **5. Develop a forward-looking risk management program**

To prepare, create a robust and agile risk management program, ensure secondary supply sources for critical goods and services, and develop a quick, user-friendly supplier onboarding program. Over time, further steps should be taken to enhance visibility and transparency in the supply base beyond tier two.

#### **6. Invest in cost-cutting technologies**

Using advanced analytics methodologies, procurement organizations can assess current-state process costs and relative business performance, in order to bring to light high-cost/low-value areas where cuts can be made safely. Our 2020 Key Issues Study revealed a projected 23% year-over-year rise in adoption of both advanced analytics solutions and data visualization tools.

#### **7. Embrace smart automation technologies**

While automation has been a big driver and enabler of procurement efficiency for years, technology's role has grown in importance more recently due to the introduction of new digital solutions. In fact, procurement organizations could execute work with 25% fewer full-time staff and at 17% lower cost than today by making the most of existing or adopting modern core automation platforms and targeted investments in smart automation – e.g., robotic process automation, smart data capture, visualization and advanced analytics, conversational interfaces, cognitive automation and agile orchestration. Smart automation technologies can help procurement both reduce costs and improve agility across the organization.

#### **8. Migrate more activities to global business services organizations and centers of excellence**

Having proved their ability to deliver superior cost efficiency through economies of scale, scope and skills, GBS organizations are taking on an ever-expanding range of procurement processes, a trend that should be accelerated. Our research shows a projected increase in the amount of work at GBS organizations and centers of excellence in 2020.

#### **CONCLUSION**

Executives cannot predict micro- and macro-economic events. However, economic bears and bulls can both agree that black-swan events like the now-global coronavirus crisis can change the outlook quickly and drastically.

It is therefore incumbent on procurement leaders to guide company management on ways to cut cost intelligently, while ensuring they can still respond quickly to a sudden rise in demand or transaction volume. Beyond an immediate change in working practices, this requires utilizing supply relationships, laying a scalable digital foundation, and optimizing the use of procurement and human resources.

# About the Advisors



## **LAURA GIBBONS**

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Ms. Gibbons has industry and consulting experience in areas such as purchase-to-pay, strategic sourcing, payment strategies, manufacturing operations, economic impact analysis, and organizational and process design. She previously worked in The Hackett Group's Strategy & Operations consulting practice, where she specialized in sourcing, procurement and supply chain. Before joining The Hackett Group, Ms. Gibbons served as Strategy & Operations Associate at Groupon.



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Mr. Walden advises senior executives of large, complex companies on topics including effective sourcing; developing procurement's internal brand; and digital technologies and their impact on operating models. With 20 years of experience in the fields of procurement and finance, he is a frequent speaker at conferences and other events in the UK and Europe, and a regular contributor to online media including Procurement Leaders, Raconteur, Supply Management and Spend Matters.



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Mr. Sawchuk leads The Hackett Group's global procurement advisory practice. He has over 20 years of experience in supply management, working directly with the Global 2000 and mid-sized companies around the world and in a variety of industries to improve all aspects of supply management, including process redesign, digital enablement, operations strategy planning, organizational change and strategic sourcing. Mr. Sawchuk specializes in working directly with CPOs to help define a long-term strategy. He is a regular contributor to business publications, a frequent presenter at industry events and author of numerous reports and books. Mr. Sawchuk's background includes engineering, operations and sales roles with both United Technologies and IBM.

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