How procurement can deliver quality of earnings in a world where price pressure is only upwards

Keystone Procurement Solutions Ltd

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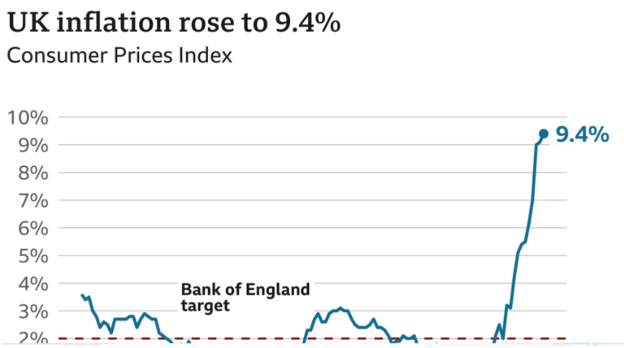
How procurement can deliver quality of earnings in a world where price pressure is only upwards

"It's not news that the UK and the rest of the world is currently in a period of high inflation. As explained in our Procurement in 3D guide against this backdrop previously Procurement teams everywhere supported their organisations with significant savings to weather the storm and now, Boardrooms, having realised the value of Procurement, look again to Procurement Team's to continue to deliver value benefits. So again Procurement team are having to redouble their efforts and think creatively to finding ways of curbing inflationary pressures" says Jody Tracey, Managing Director at Keystone Procurement Solutions, here he shares five simple ways that Procurement can continue to deliver quality of earnings in a world where price pressure is only upwards.

Background

Inflation, measured by the ONS CPIH rate rose to 9.4% in June, the largest movements in the annual Consumer Prices Index including owner occupiers' housing costs (CPIH) inflation rate in June 2022 came from transport and food.



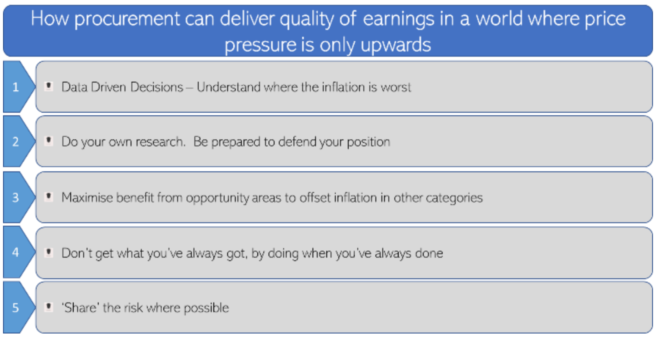
Transport
The annual increase for transport was 15.2% in June 2022. Over the past two years, the annual rate has risen from minus 1.5% in June 2020 (during the first coronavirus (COVID-19) lockdown) to the latest figure for June 2022.

Food and non-alcoholic beverages
Food and non-alcoholic beverage prices have risen by 9.8% in the year to June 2022, up from 8.7% in May, and the highest rate since March 2009. The annual rate partly reflects price rises over the latest few months, including a 1.2% rise between May and June 2022.

Clothing and footwear
The annual rate for clothing and footwear was 6.1% in the year to June 2022, down from 6.9% in May. Prices were little changed on the month in 2022 but rose by 0.8% between May and June 2021. Prices normally fall at this time of year as the summer sales season begins, but there was little movement in 2022 and, in 2021, prices were still rising following the end of the coronavirus lockdown.

Step 1: Data Driven Decisions – Understand where the inflation is worst

In all businesses input cost inflation will differ from one category to another. As an example, high energy input manufacturing such as insulation or brick and blocks are likely to have significant cost pressures associated to energy and transport costs, however service sectors, such as consultancy for instance may see inflationary pressures linked to software or labour for instance.



Categorising your supply base by supply market sector / spend value / strategic importance will allow you to identify the focal points and prioritise your negotiations. By then including a ranking against inflationary inputs further narrows the target on spend areas and individual suppliers.

Step 2: Do your own research. Be prepared to defend your position

Procurement teams at over the past 12 – 18 months will have seen an unprecedented level of price increase notifications. In many cases there will be justification for these increases, in part, however a number will be an opportunistic reaction to activity in the market.

Supplier price increases requests start as just that, a request to be accepted or not. Everything is negotiable but to be effective in the negotiations Procurement teams need to be arms with facts and figures pertaining to the input costs in question.

In many cases, suppliers with justification for an increase will be able to produce data to support their position, and this is a good way to sort the justified from the opportunistic, but buyer beware. Don't always trust a supplier's numbers. Do your own research and form a counter argument. A great starting point is levels of increases notified by suppliers of similar goods / services.

Finally, its important to understand your position with regard to how much cost inflation you can pass on and communicate that effectively to your suppliers. If you have fixed prices to your customers, or limits to increases then any inflation beyond will be at the expense of your margin if you cannot negotiate a position with your supplier where this is protected.

Step 3: Maximise benefit from opportunity areas to offset inflation in other categories

Even now there will be categories where inflation is either less prevalent, or in a phase of deflation. These areas are likely to deliver significant savings if they can be renegotiated in the current market environment. These markets will be clearly identifiable as Buyers Markets where the Procurement team have the power in any negotiations.

Understanding that many sectors are still returning to business and normal as we catch up with pent up demand resulting from the pandemic many suppliers are still driving to maximise this opportunity and compete for new business or retain existing spend. As an example; if you feel that Events and Conferencing spend is likely to return to pre-pandemic levels quickly in your organisation then areas of focus may be catering providers, hotels and conference venues as well as travel

Lastly, don't ignore areas of spend, often not Goods for Resale that are not regularly reviewed by Procurement teams such as banking charges, maintenance costs and insurance.

Step 4: Don't get what you've always got, by doing when you've always done

When savings become harder to find using established techniques such as negotiation, tendering, leverage or relationships that result in buying something for less then it is important not to be scared of plan B.

In a period of high-cost inflation for almost all, looking for savings through techniques such as Value engineering are likely to be more successful. That value could be found in either product composition, think shrinkflation, or life cycle costing or a re-imagined supply chain.

Negotiation Levers	
Traditional Levels	Additional Levers
Tendering / Market Review	Specification Change
Renegotiation	Process Optimisation
Consolidation/Aggregation	Demand Management
Low Cost Country Sourcing	Supply Chain Reconfiguration

Demand management goes deep into the internal drivers of demand, working out ways to reduce and eliminate. Simple examples range from making sure obsolete mobile lines are not paid for, right through to technical invest-to-save initiatives which reduce energy consumption.

Reworking specifications takes a value analysis and engineering approach to products and services, systematically working through opportunities to optimise materials and processes to lower costs.

This provides a perfect catalyst to weave-in ESG objectives, looking to engineer specification change to both lower cost and drive sustainability.

Process optimisation considers every aspect of the value chain in order to identify where efficiencies can be realised or where win-win scenarios with suppliers can be created. We work with clients to take-apart and rebuild each element of the value chain optimising the flow of information, material and money in areas such as forecasting, order quantities, transportation, logistics right down to packaging and returns.

Reconfiguring supply chains to give a lower end-to-end total cost of ownership combined with a risk diversification objective considers where and how to rework the supply base and build an optimum supply chain. We are already seeing an over-riding near-shoring of critical supply categories.
The downside of this approach that cost optimisation is harder and will take longer to implement.
The upside is that the impact will be a bigger step-change rather than a smaller incremental impact.
The prize is bigger savings, but they are harder to get.

We also believe this is an ideal opportunity to drive the Sustainable Procurement agenda in parallel. The internal levers naturally lend themselves to the delivery of improved ESG outcomes, for example greener specifications, less packaging and reduced CO_2 emissions from shorter supply chains.

Step 5: ‘Share’ the risk where possible

Finally, procurement leaders should structure commercial arrangements which take into account inflation and protect their organisations from future impacts. They can do this by looking to shift the risk; either back to suppliers, on to customers, using financial instruments to hedge exposure, and by using their own internal processes to manage pricing opportunities, such as stockpiling inventory or spot-buying or switching specifications.

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