

The Impact of Inflation

Part Three: Where Next? What we should be doing

Introducing



Tim Cummins

President

World Commerce &
Contracting



Robert Handfield

Executive Director

Supply Chain Resource
Cooperative



Simon Geale

Executive Vice
President, Procurement

Proxima

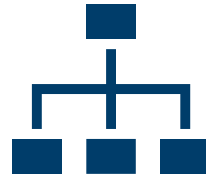
Last time: some commercial forecasts

- There will be attempts to shorten supply chains – but not easy or quick to achieve
- Moves away from China will accelerate
- ‘Just in case’ stocking has contributed to inflation – and de-stocking will assist in its reduction
- Working capital under strain: cannot stretch payables, but will lead to payment delays / growth in receivables
- Growing demand by suppliers for pre-payment
- Increased borrowing costs will drive demand for other liquidity sources – e.g. factoring, inventory financing – but risk premiums will rise
- Increased stimulus by Governments to encourage reshoring and expanded manufacturing
- Need for far greater collaboration between Finance, Procurement and Commercial to undertake cash flow forecasting
- SME’s vulnerable to cash shortages, production delays

Critical needs



Better, faster and more comprehensive analytics



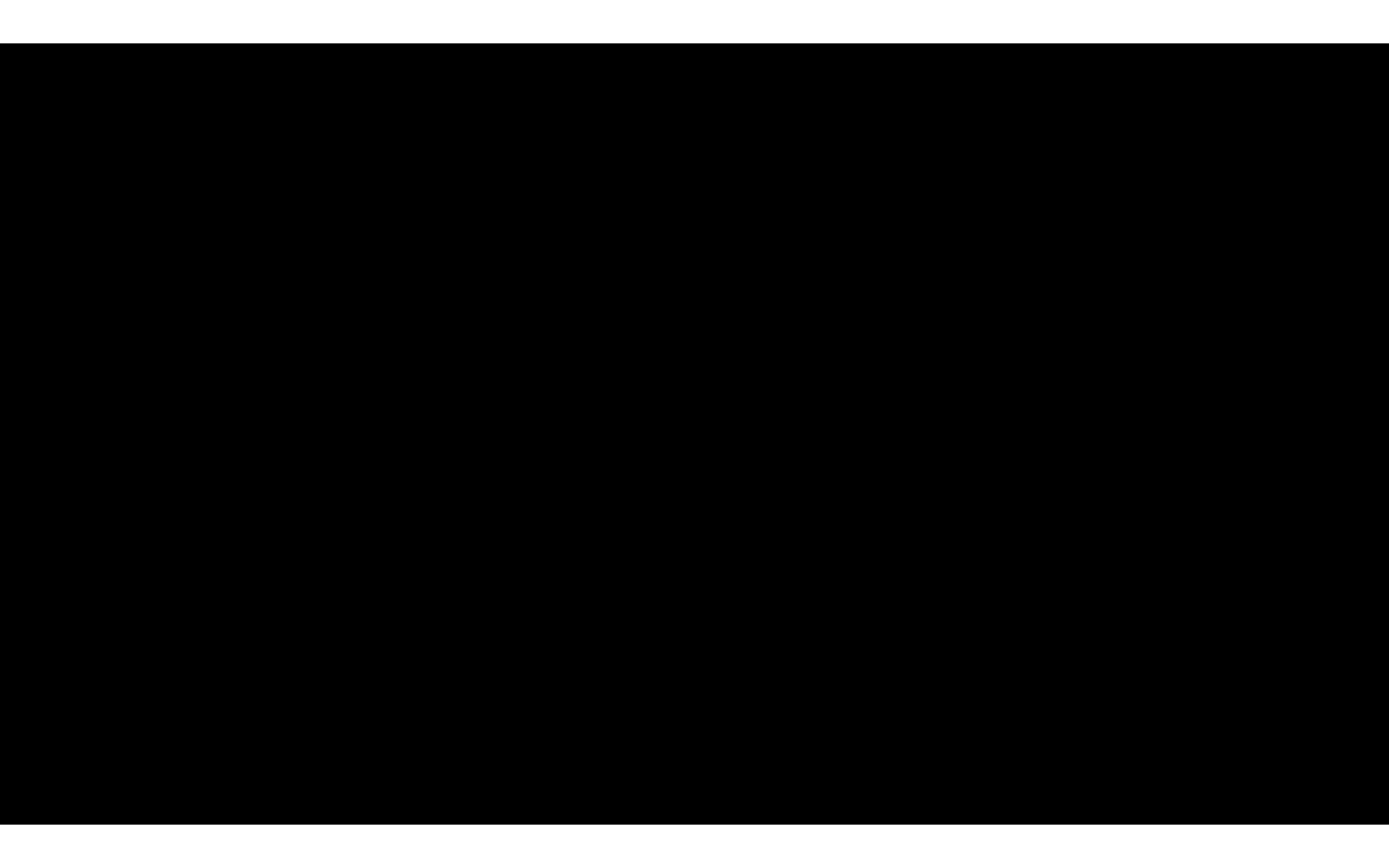
Greater transparency of data, internal and external

- sources of supply
- customer and supplier cost and overhead structures

Q&A with Jason Miller

Associate Professor,
Supply Chain Management
Michigan State University





How prepared are organizations?

Clients:

- Many are handling inflation as the latest in a series of disruptions
- Reliability of supply the major concern
 - Many undertaking a supply strategy review
 - Situational response to those suppliers who push for increase
- Lack of visibility into supply networks and cost structures impedes ability to reach agreement on true inflation

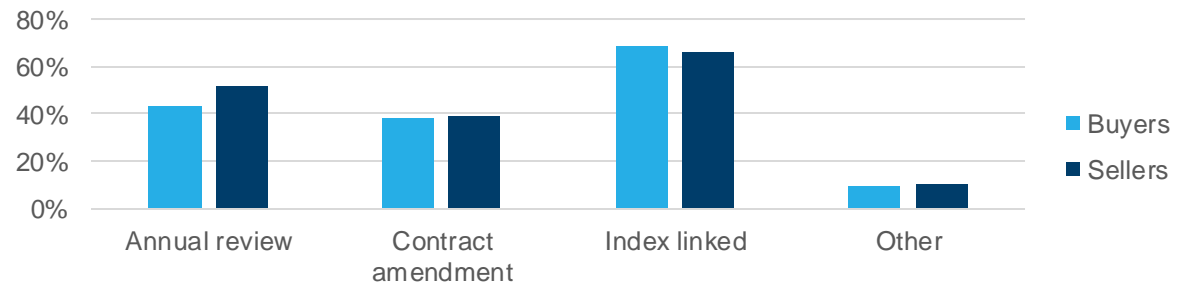
Supplier:

- 71% of respondents typically have price change provisions embedded in their contracts
- Only 41% have comprehensive cost structure data to calculate & justify price changes
- Account teams not typically equipped for the conversations required by customers

Good practice:

- Uncertainty management embedded in business processes and decisions
- Organizations which are equipping customer or supplier interfaces to enter into collaborative discussions, mitigating tension and moving away from pure risk transfer to risk re-balancing

Existing approaches to price change



Impact on relationships & collaboration

- Inflationary pressures are generating increased tension between clients and suppliers
- The reaction is not uniform and influenced by multiple factors - industry, geography and type of contract
- Clients and suppliers agree that the strength of relationship is the biggest single factor influencing behavior, but differ in their view of the extent to which collaboration has been realized
- For the best performers greater collaboration is reflected in discussions on shared approaches to cost reductions or margin protection

Good practice:

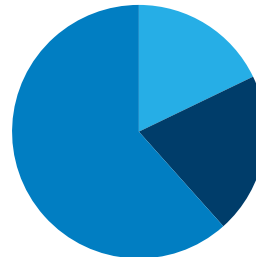
Pursuing innovation/ continuous improvement to help maintain price e.g.:

- Adjusting scope or timing to fit budget
- Re-inventing roles, responsibilities and interfaces to enhance efficiency/ cut costs
- Trading the cost of innovation/CI for enhanced margins, longer commitment, better payment terms, etc...

70%+

of respondents see a discernible difference in approach based on strength / quality of relationship

How are customers typically responding to requests



- Rejecting requests
- Ready to discuss, but demanding below inflation increases
- Ready to discuss, but wanting to explore possible cost reduction measures

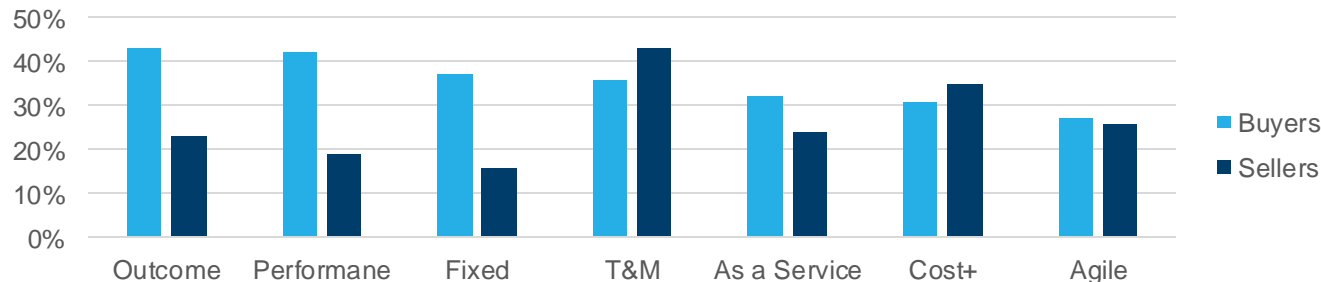
Impact on contracts & pricing models

- The need to quickly assess rights and obligations in the current contract portfolio is adding to the urgency of implementing automated contract review, analysis and reporting
- 83% of suppliers are actively seeking to increase prices (though currently c.45% in long term services)
- Clients (67%) and suppliers (76%) are revising or inserting additional terms relating to pricing / price increases
- Progressive organizations are considering price adjustment mechanisms that include future price decreases and how they will be shared
- Emerging pressure to increase the use of alternative contracting and pricing models which improve control / predictability – but client and supplier have different views on future direction

Good practice:

- Seeing commercial models as business solutions rather than risk transfer mechanisms
- Ensuring organizational capability to perform to new commercial / pricing models
- Taking a collaborative, holistic design led approach to the creation and implementation of commercial models

% anticipating greater use of contract model



Implications for capabilities required

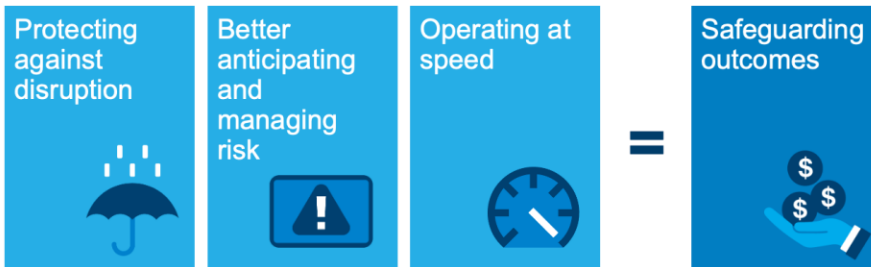
- Continued market disruption is elevating the importance of adaptive commercial competency (for suppliers this is a key differentiator)
- Greater transparency and data sharing through digitization and commercial data management, enabling value adding trade-offs through empowered and informed interfaces to clients
- In many organizations there is a need for better internal collaboration and information flows e.g. between CCM and relationship management, procurement to sales, etc...

Good practice:

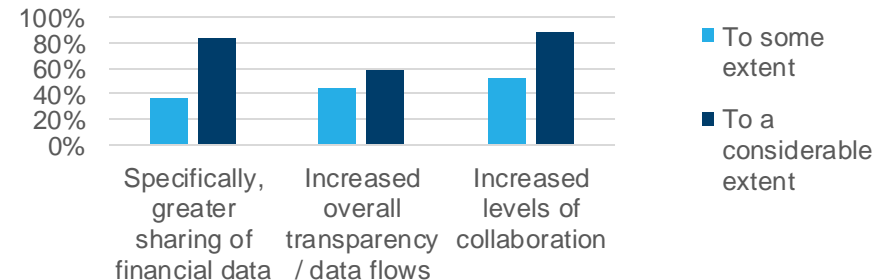
Capabilities need to be focused on enhancing commercial competency through commercial data management & digitization. Providing quality decision support insights e.g.:

- the real rate of inflation for a project, deal or business
- which elements of inflation are temporary vs. structural
- develop integrated 'contract, governance, relationship' models

Delivering increased value in an uncertain world



Shifts in market behaviors as seen by clients



Summary of actions being taken by customers

- More intelligent supplier selection: expanded view of ‘what makes a supplier risky’.
- Greater diligence in gathering market rates, recognizing where current rate cards are unrealistic and threatening quality of supply. Selective increases being made to protect services
- Procurement teams more engaged in demand and workforce planning.
- Evolving size and capabilities of contract management and supplier relationship management.
- Greater focus on becoming ‘a customer of choice’ for key suppliers.
- Consolidate or increase spend with major suppliers to increase leverage, reduce scale of price increases (NOTE: This may have negative impact on SME targets / diversity and inclusion goals, unless SMEs operate under umbrella of larger suppliers)
- Reduce volume of ‘tail’ suppliers / address concerns over ability of smaller suppliers to deliver
- Award selective contracts without going to market, especially when market rates are known to be higher than existing contract. (This also offers cost avoidance for incumbent supplier.)
- Increased appraisal (by both buyers and suppliers) of on-shore / off-shore resource mix.
- Strong focus on innovations that reduce either the volume or the skill level of required resources.
- Even a consideration for Public Sector – recognition that award to an existing supplier and thereby expanding amount of business can reduce cost

Summary of actions being taken by suppliers

- Closer coordination between (sell-side) CCM and relationship managers, procurement/ supply chain.
- Increasing analysis and understanding of cost structure breakdown.
- If contracting fixed price, building in a bigger risk premium.
- Looking at alternative value sources that justify increases – for example, new technology that could generate carbon saving.
- Accelerating digitization initiatives to cut back on human resources; also, further transfers of work to lower cost alternatives.
- CPI remains the ‘index of choice’, but often involves the need for fall-back positions – for example, insertion of a cap, or an agreed split of the rate, or incentives to be creative in avoidance – perhaps a more favorable division of benefits from cost reductions. Use of a mix of indices related to cost elements.
- Planning for the future by incorporating ‘de-escalation’ provisions and indices.
- There are some indications of in-sourcing by customers to gain greater control over cost, but this is the exception

Next time...

That's up to you! What would you like to know, or to share?