NewDawn Briefing Supplier Price Inflation—Reality or Perception?

Scenario

Back in summer 2020 The NewDawn Partnership circulated a document on the topic of "Coming out of the Covid-19 Emergency". We urged you all to ensure you were very well prepared for a series of possibly very tough negotiations.

We hope you took advantage of that advice, to ensure your various negotiation teams were fully refreshed, and ready for the battle. Many of our clients have advised that the forecasted scenario has most certainly arrived, and a lot of time is now being expended resisting price increases from a wide variety of Supply Chains.

Is this Real or Conditioning?

The Reality?

As we predicted last summer, the scenario is such that many companies will be seeking to use the Macro Global Growth position to push for such increases, probably to help fund the losses incurred during 2020, when economic activity showed varying levels of reduction across many industries.

We have heard recently of many examples of suppliers pushing for increases on the back of potential supply shortages, where demand exceeds supply, and therefore under the theory of economics pricing will rise in such situations. Several were not justified, and agreements reached far below the increases requested—in some cases zero was achieved, when requests were for increases of 7%or more.

This is not new behaviour—in previous decades **"Opportunistic Pricing"** was quite often the case—they all sounded plausible, but well focused Procurement teams were able to overcome such situations.

There are a couple of key questions:

- **Are the price rises real or opportunistic?**
- **How well prepared and focused are your procurement teams to be able to effectively challenge the situations that are opportunistic rather than real?**
- **Are we really seeing the rise of Cartel/Orderly Marketing pricing to rapidly recover financial problems from the Pandemic in 2020 (see Page 3 Crude Oil v Chemicals)?**

In previous such periods of Substantial Price Inflation many of the so called **"Shortages Driving Pricing Upwards"** were ***NOT TRUE!!—They were conditioning messages used by suppliers to drive FEAR into the minds of customers, and to enhance their own profitability.***

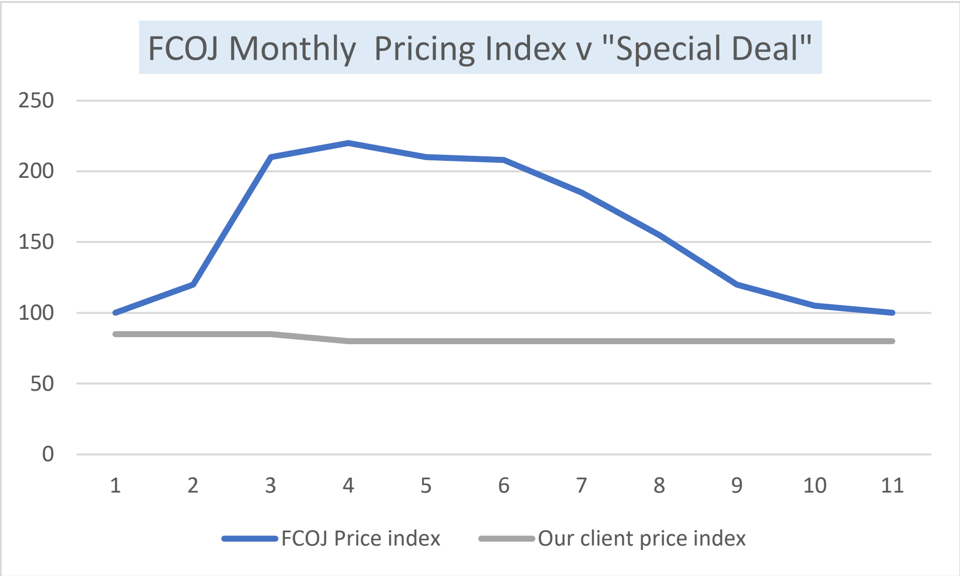
Are we seeing a repeat now as business owners recognise if they stir fear in the mind of the customer, panic sales will increase short term revenue to help offset the ravages of Covid-19 shutdowns?

Let us now look at 2 examples—one very current and one historical:

- **Historical--Frozen Concentrated Orange Juice**
- **Current Crude Oil and its Impact on Inflation**

Historical Example-- Frozen Concentrated Orange Juice

- As an example, in late December one year, the headlines on TV and in the press locally were **"Frosts in Florida Decimates Orange Groves"**
- It was true, Frosts had decimated some Orange Groves in Florida but not all, nor enough to damage the global or local supply/demand situation, but that was not the public perception.
- The fever pitch was high, and FCOJ (Frozen Concentrated Orange Juice) prices were rising by the hour, because of the **"Global Demand/Supply Imbalance"**
- When checked in detail with photographic records taken by a staff member of the client who was dispatched to visit the many acres of Orange Groves in Florida, and to come back with a complete picture. The outcome was that only a few acres were damaged. The vast majority- well over 95%-- seemed to have no damage at all!!



- ***When confronted with such physical evidence, the suppliers, under strict confidentiality agreements, quickly reached a different agreement with the this one client who had this evidence. That client fully avoided the large increases others complained about. <u>It made a very big difference to their profit margins</u>.***
- Prices for FCOJ in the market had more than doubled in a few weeks as **"panic buying"** led by the traders and fuelled by press speculation took a real grip. The prices in the market eased a little and then dropped back to normal over a 12-month period as the next crop matured, as evidenced by the chart above.
- ***<u>This shows the power of publicity pushed by some form of hysterical media—in this case Local TV stations, and Press, and then used as evidence by Traders.</u>***

How many of the current pricing increase problem situations are as fabricated as the above situation??

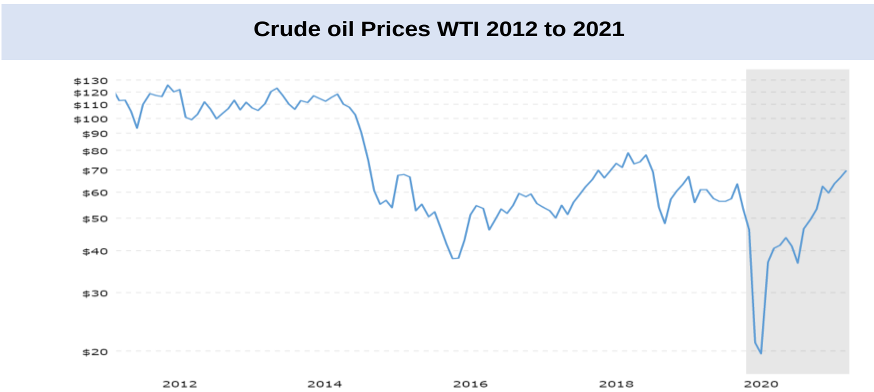
For sure there are some problem areas, but even within those some crucial questions based on real fact may well open up some very interesting negotiation opportunities

Current Example--Crude Oil

- Has seen substantially volatility in price since going down from US$ 120+ per barrel in August 2013 down to US$ 38 back in Feb 2016.
- It recovered to US$ 77.50 in August 2018 and a low of US$ 19.63 in April 2020. As of November 1, 2021, it was back knocking on the door of US$ 85 per barrel
- One wonders if the materials that relate back to crude in their supply chain showed the large reductions over early 2014 to current?? If so, it would seem that todays "new prices" being paid by Industry and the consumer should be rather lower than they were in early 2014, as the oil price is still circa 30% below its peak in 2014!!. ***A question for your category teams is if not why not, and what are you doing about it right now?***

- ***In the last few days for consumers, pump prices for fuel were blamed on large increases in crude oil—that is just not true!!***
  - ***The price of crude is very adjacent to where it was in July 2005 in US $ per barrel terms***
  - ***In those days according to the Institute for Fiscal Studies the price per litre of petrol excluding Fuel Duty and VAT was 25.78 pence per litre. Today from the 140.9 pence per litre pump price, the equivalent without Duty and VAT plus adjustment for currency variation seems to be 54.5 pence per litre—an increase of 111% for the product, when crude is minus 30%!***
  - ***Wonder where that extra 33.72 pence per litre of profit is going???***

- See chart below—should provoke some questions to your Category Teams for any items they buy where pricing is linked to oil



Source ref='https://www.macrotrends.net/1369/crude-oil-price-history-chart'>Crude Oil Prices -

- **Related Products e.g. Chemicals—**
  - Do the historical actual prices you pay follow a similar pattern to the above chart—**if not why not?**
  - Maybe it is opportunistic behaviour, maybe on some products Cartel Behaviour or at the very least "Orderly Marketing" is happening. (i.e. companies either formally or informally fixing prices at a high level)

- **Surely a highly skilled, and focused Procurement's team job is to not have such problems, even when the rest of the market does?**

In today's world surely the Procurement Teams can and should be standing up to such Opportunism shown in the 2 examples?

Resistance to Supplier Price Inflation—5 Key Steps

- When did you last encourage your teams to be very creative in their analysis of the data and come up with their own fact-based targets that might be ***VERY*** different from what the suppliers are suggesting?
- If your team has not been refreshed in the last 2-3 years on their Negotiation skills, particularly in how to overcome Supplier Price Increase requests that are not necessary, then your team will not be "match fit". Negotiation via Zoom or Microsoft teams is NOT the same nor as productive as face to face. It also requires some additional skills, they might not have.
- Hopefully your Cost Avoidance performance is showing excellent results right now, (the variance between prices requested in the market and your actual agreement), thus helping your company grow it's margin rather than see it be eroded by unnecessary supplier price increases.
- ***<u>NewDawn can help coach your teams to ensure you are optimising the chances of your Company being well enabled to take advantage of this situation rather then being a victim.</u>***

Contact us:

https://www.newdawnpartners.com

- simon.buzza@newdawnpartners..com +44 (0)7860 545590
- alan.cooley@newdawnpartners.com +44 (0)7768 600735