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With Dropping Commodity Prices and Demand, Now is Time to be Savvy with Vendor Negotiations

"Cost Drivers have Changed," Says One Procurement Director, but New Contracts May Yet Reflect the Market Changes

SCDigest Editorial Staff

With the global financial crisis and related economic slow down, commodity prices from oil to metals to agricultural products have fallen dramatically. Over the past few months, oil prices fell quickly from highs approaching $150 per barrel to the $120s, then the $100s, and now this week close to just $80 per barrel.

Other commodities have seen similar dramatic price declines. Natural gas, for example, has gone from over $13 per million BTUs to less than $7.00 currently. Copper prices are down more than 25% in 2008, and almost 50% from 2008 peaks, with a similar story for other metals (see illustration page 2). Leading steel makers recently announced they are planning output cuts to cope with lower prices and demand.

Though the drop may be less sharp in some agricultural products, because people still need to eat, Goldman Sachs this week lowered its three-month forecast for corn prices to $5 per bushel, down from its previous prediction of $6.50 a bushel, while wheat was revised down to $6.50 from $7.50 a bushel. Other agricultural commodities are expected to see similar declines, at least for the short term.

New Supplier Contracts

The drop in some of the commodity prices have been so sudden that supplier pricing strategies and proposals, and the response from procurement managers, need to be looked at very carefully.

As suppliers start the process of offering price proposals for 2009, for example, many may reflect the prices of several weeks back, before the most recent commodity cost declines, and propose price increases to buyers supposedly due to higher costs at the supplier that do not reflect the latest market conditions.

Lower oil prices will directly impact the cost of raw materials for the chemicals themselves, but sharply lower natural gas prices should also have a big impact on production costs of most chemical manufacturers, which rely on natural gas to power a high percentage of production processes.

"We seen a number of 2009 contracts that propose higher prices for a range of products," one director of procurement for an office products company told SCDigest last week.

"I'm telling my people: Get smart. Look at their cost drivers. They have changed significantly. Their input prices are going down. We should not be looking at price increases in most cases, but price decreases."

In some cases, the changes in input costs are clear; for example, lower corn prices will directly reduce the cost to product a derivative products, such as corn syrup.

In some cases, the connection is less direct. A perfect example is chemicals. Lower oil prices will di-

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	Prices				Inventories MT			
	12/31/07	**10/10/08**	**Change**	**%**	**12/31/07**	**10/10/2008**	**Change**	**%**
$US / Euro	0.6850	0.7455	0.0605	8.8%				
Cx Silver	$14.80	$10.55	-$4.25	-28.7%				
Cx Gold	$834.90	$855.40	$20.50	2.5%				
Cx Copper	$3.0305	$2.1565	-$0.8740	-28.8%	14,056	8,676	-5,380	-38.3%
LME Copper	$3.0282	$2.2680	-$0.7602	-25.1%	197,450	209,400	11,950	6.1%
Shanghai Copper					25,597	25,681	84	0.3%
Total Copper					**237,103**	**243,757**	**6,654**	**2.8%**
LME Aluminum	$1.0659	$0.9807	-$0.0852	-8.0%	930,025	1,396,025	466,000	50.1%
LME Lead	$1.1485	$0.6731	-$0.4754	-41.4%	45,475	63,000	17,525	38.5%
LME Tin	$7.4299	$6.2596	-$1.1703	-15.8%	12,100	5,580	-6,520	-53.9%
LME Nickel	$11.7050	$5.4204	-$6.2846	-53.7%	47,946	54,936	6,990	14.6%
LME Zinc	$1.0387	$0.6060	-$0.4327	-41.7%	89,150	166,525	77,375	86.8%

Source: The Copper Journal

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It's also unclear how long this depressed commodity price market will continue. While some experts are saying it's possible that oil prices could drop to as low as $50-60 per barrel, OPEC is planning reductions in output, and demand may pick up again faster than expected. Geo-political developments can quickly impact oil and other commodity prices. The World Trade Organization is still predicting near 10% economic growth – and resulting raw materials demand – in China.

So, companies may be smart to lock in deals at these commodity price levels if they believe we are close to a bottom in many areas.