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If Key Suppliers are Struggling Financially, What Should Procurement Organizations Do?

From Co-Buys to Reducing Payment Terms, Procurement Managers Need to Have Tool Sets in Place

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The economic downturn continues to manifest itself in many ways, and certainly one of them is the risk many companies will face in terms of some of their suppliers being under significant financial pressures.

This scenario has already dramatically unfolded for many companies sourcing from China, where manufacturers have been going out of business by the tens of thousands over the past year, in some cases literally overnight, with little or no advanced warning. (See **Will there Turn out to be a "China Import Bubble" Too?**)

Many companies in home domestic markets will also be under pressure of course, especially smaller companies that are not well capitalized, or are in industries that have contracted especially hard.

If the supplier is for a commodity product that is purchased in a pretty basic way, its failure in the mid-term is not much of an issue, as alternative suppliers can easily be found. Even in this situation, however, procurement managers need to be on their toes to avoid short term supply chain disruptions in the event of a rapid and unexpected failure of a supplier or inability to deliver. One still hears occasional stories, for example, of companies temporarily unable to ship product because of a shortage of corrugate boxes or similar supply problems for basic items.

But if the product or relationship is more specialized, additional options and planning need to be considered. Even for some purchased products that tend more towards the commodity end of the scale, the level of integration and collaboration between supplier and buyer can have value that makes it in the buyer's best interest to ensure the health of that supplier.

A key factor in the financial struggles of many suppliers is that their customers often pay even more slowly than usual as they face their own economic challenges. Such cash flow issues, more than issues with the fundamental business, are often the direct cause of a supplier failure.

Below are some strategies companies can consider to help struggling key suppliers:

Co-Buy Arrangements

Financially strapped suppliers may be late paying their own suppliers, and as a result have troubles getting the materials needed to make the products they sell. In that case, a company may want to consider buying the raw materials or components a supplier needs directly, and then receive the appropriate discount on the finished product.

In some cases, the end company's buying power

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or procurement sophistication might even result in obtaining a lower price for the material than the supplier was receiving, saving costs as well as continuing supply.

Collateralized Loans

A company can consider extending a bridge loan to a trouble supplier, generally secured with some asset, such as equipment or real estate.

However, in both the co-buy and loan strategies, as well as other financially-oriented moves, companies need to "make sure the assistance is structured in a way that the assisting company is not taking on unwanted liabilities from the receiving supplier," cautions **Gregg Brandyberry**, vice president procurement, global systems and operations, for GlaxoSmithKline, in a recent edition of ISM's ***Inside Supply Management*** magazine.

Improve Payment Terms

A key factor in the financial struggles of many suppliers is that their customers often pay even more slowly than usual as they face their own economic challenges. Such cash flow issues, more than issues with the fundamental business, are often the direct cause of a supplier failure.

For strategic suppliers facing cash flow issues, companies can consider actually speeding payment terms, rather than stretching them out.

Operational Assistance

Often, a large company has expertise in procurement, manufacturing and other disciplines

that could help a struggling supplier increase its own efficiency. For example, a company with strong Lean manufacturing expertise might be able to quickly identify some process changes that would reduce a supplier's internal costs. Ditto with procurement processes (e.g., are there opportunities for on-line reverse auctions that aren't being used?).

While in good times suppliers may not welcome such unsolicited "advice," struggling firms may be much more open to the idea.

Accept Price Increases

While probably an item of last resort, companies can consider accepting a price increase from a struggling supplier. This strategy probably makes the most sense where a supplier price was locked for the contract period and its own cost drivers (material costs, etc.) have moved upward.

Finally, companies of course need to be prepared should a supplier fail, through the usual tactics of dual sourcing, holding inventory, etc. But an often overlooked step, especially when sourcing globally from low cost countries, is making sure intellectual property is secured and recoverable.