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Just How Hard Should You Pressure Suppliers for Price Cuts During Downturn ?

Procter & Gamble Exec Says Unilateral Demand for Concessions are Bad Business, While BP Looks for "Deflation" in its Supply Chain

SCDigest Editorial Staff

It's a down economy. Top line revenue for most companies is under pressure, and executives are naturally looking at the procurement function to deliver savings through reduced prices from suppliers.

But just how far is it wise to take that approach? And what are some ways to do it more intelligently so that the long term isn't sacrificed for short term gains?

On a recent webinar, Rick Hughes, vice-president of global purchasing at Procter & Gamble, said that P&G is taking a less aggressive approach this time.

Insisting on unilateral price cuts in an attempt to improve your company's financial position is "a very dangerous proposition in the short term as well as in the long term,' Hughes said.

During tough times for P&G in the late 1990s, the company tried that approach – and only achieved about 5% of the initially expected savings.

"It didn't prove very beneficial," he added, "and in today's environment I suspect that if we did that we'd cause some additional suppliers to have financial or liquidity problems... and in some cases maybe even go into insolvency."

Picking Your Spots

One of the challenges, of course, is that right now many suppliers are themselves on precarious financial ground, and beating them up on price could put some under or force them to cut costs, like quality or delivery, to make up the difference.

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However, with the steep drop in commodity costs over the past year, many suppliers of products closely tied to commodity price swings may be good candidates for pressure to reduce costs, just as those suppliers generally pushed prices upward as they cited rising commodity costs until the bottom started to fall out in 2008.

Ironically, many retailers are pressuring consumer packaged goods manufacturers such as Procter & Gamble to reduce prices because many of their input costs, from oil-based products to agricultural commodities, have dropped dramatically.

That was part of the message delivered recently by BP, where **Tony Hayward**, chief executive of the energy giant, said he wanted to "drive deflation into the supply chain" to reverse the surge it had seen in costs the past few years. He told analysts prices for metals and energy had fallen 60-70 percent, which would eventually flow through to suppliers' prices, adding: "Our challenge is to accelerate that flow-through as rapidly as possible."

Non-strategic and indirect/MRO materials may also offer smart targets, as there is much less risk from changing suppliers if incumbent vendors refuse to meet pricing "requests" or in the end they don't survive the recession. Many other suppliers may

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be happy to take the business at the requested lower price levels.

However, companies really do need to be careful about pushing too hard on strategic suppliers, especially those that have had less benefit from falling commodity prices.

That's the view of **Tom Rae**, group director of procurement at NSG Group, one of the world's leading glass makers.

"We would never, ever apply a price-attack approach in such [strategic supplier] categories, because these guys are incredibly important to us in the long term," Rae said during the webinar. "We have to find ways to cut costs without damaging relationships – and being consistent in the relationships we are trying to build."

But, Rae also said his team was pushing for price reductions in energy and commodities where market prices had come down, and in non-critical categories.

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