

Key Procurement Strategies in an Inflationary Environment



With prices going up across the board right now and the national inflation rate hitting a 40-year high, procurement professionals are using new strategies to operate in this volatile environment.

The U.S. annual inflation rate reached 8.5% in March, the highest since December 1981 and an increase over February's 7.9% inflation rate. Some of the key factors pushing prices up right now include energy costs (up 32%) and gasoline prices (48%); food prices (8.8%); housing costs (5%); and new vehicles (12.5%).

Excluding volatile energy and food categories, *Trading Economics* says the consumer price index—a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods—rose 6.5% in March. That was the highest jump in the last four decades.

“Many analysts expect that March will mark the peak in inflation although the war in Ukraine is far from over,” *Trading Economics* reports, “supply chain bottlenecks persist and consumer demand remains elevated which is likely to weigh on the CPI for longer.”

Tracking Economic Trends

According to a [new Gallup poll](#), Americans' confidence in the economy remains very low, and mentions of economic issues as the most important problem in the U.S. are at their highest point since 2016.

Inflation, which registered as the top economic problem last month and continues to be, was previously at this level in 1984. Gallup regularly tracks Americans' ratings of national economic conditions as excellent, good, and only fair or poor, as well as their views on whether the economy is getting better or worse.

Gallup's latest poll was conducted April 1-19. Four in five U.S. adults rate current economic conditions in the country as only fair (38%) or poor (42%), with few describing conditions as excellent (2%) or good (18%). Furthermore, 76% of Americans say the economy is getting worse, 20% say it is improving and 3% think it is staying the same.

Facing Fundamental Changes

Before the pandemic reared its ugly head in early 2020, rising productivity and declining costs for many inputs—achieved through lean and just-in-time strategies and the globalization of supply chains, among other factors—created a favorable environment for procurement professionals and their organizations.

Now, *McKinsey & Co.* says procurement organizations are facing fundamental changes to management practices, capabilities and supplier ecosystems based on now-outdated assumptions. “We are no longer in a world where assuming an ‘annual RFP will yield 3 percent price savings’ is a viable operating model,” the research firm says. “After a year of continual and intensive action to adapt, many procurement organizations have deepened their understanding of their supply chains and deployed new levers. But more can be done.”

Here are four strategies that *McKinsey* says all procurement organizations can take now to operate more efficiently and effectively in the current inflationary environment:

1. Know what you're spending. “Transparency into spend and a view on input cost inflation by category and geogra-

phy are critical,” it says. “Gaining these insights requires an intimate understanding of the supply base and its economic drivers. Some leading companies are already increasing their use of indexing and should-costing to determine the areas of exposure and create fact bases for discussions with suppliers.

2. Discovering new regions for sourcing. Offshoring and nearshoring have both allowed companies to access suppliers with different cost structures and pressures. “To master the art of regional diversification, procurement leaders balance the pricing improvements from new suppliers with the supply chain changes required to access them,” McKinsey advises. For example, one electronics manufacturer responded to logistics challenges encountered in delivering products from Asia by expanding production to the U.S. and Mexico.

3. Build stronger partnerships with suppliers. In the past, McKinsey says these partnerships have often focused on securing supply rather than capturing savings. That needs to change. “Building strong supplier relationships not only helps a company obtain supply in an allocation environment but also positions it to benefit from future cost-saving opportunities,” it points out, noting that some semiconductor buyers that have stuck with their supply partners during the good and bad times now benefit from preferred access to inventory from orders canceled by other customers.

4. Demonstrate procurement’s value to the overall enterprise. When this happens, it sets the stage for procurement leaders to become full-fledged strategic partners to CEOs, CFOs and COOs. “They can expand from being the guardians of a portion of enterprise costs,” McKinsey concludes, “and use their deep expertise in supplier markets to help lead cross-functional teams focused on long-term, full-potential value creation and ultimate enterprise success.”