Saving for a Rainy Day

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In commercial markets all over the world it is pretty obvious that the balance of power has shifted dramatically, and in some cases very suddenly, from sellers to buyers. This shift often presents important strategic choices in how to best leverage the buyer's newly regained advantage. Today's conditions often present choices between maximizing short term gain versus optimizing longer term value. In many cases these choices differentiate strategic sourcing from opportunistic buying. While neither choice is inherently good or bad, wise or unwise, the choice between short term and long term must be one that is both informed and rational not predetermined or emotional. In most cases it is also a choice that should not be made in a vacuum but should be built on broad based consensus across various organizations and stakeholders within the buyer's organization.

As the worldwide recession deepens buyers everywhere can anticipate long awaited price relief. Yes, this price relief will deliver much needed improvement in the buyer's short term financial results and will no doubt be welcome news throughout the buyer's enterprise. But before leaping to capitalize on all these immediate cost savings opportunities it may be prudent to consider leaving some of this money in the seller's coffers in exchange for more stable future pricing.

For example, let's say you are buying a material made from a petrochemical feedstock and your pricing is tied to an escalation/de-escalation formula wherein the seller passes through quarterly price changes at $x/unit. In today's market $x represents a big reduction after years of quarterly increases. Instead of taking the full reduction you are entitled to now see if your supplier is receptive to a reformulation of the current pricing scheme. Offer to give back to the supplier some of today's reduction if the supplier is willing to take a bigger share of future increases. There are lots of reasons why a seller might agree to this. Maybe they need today's savings more than you. Maybe they see other ways to hedge future increases that would not work for you. Maybe they are just willing to take more risk against future increases, and so on…

Obviously if you need every penny of the current reduction just to remain solvent then this option makes no sense for you but if you are able to forego some of the immediate savings you may be able to create a very simple and effective hedge against future increases.

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