KPMG
Elevate
Perspectives

KPMG insight on handling price spikes and material shortages
Weather the supply chain storm

KPMG insight on handling price spikes and material shortages

The problem: It’s no secret that COVID-19 has brought supply chain challenges that range from shipping and raw material price increases to a truck driver shortage (and the havoc has also touched other business issues coming out of the pandemic, such as worker treatment and inflation). This is a complex problem that isn’t going away.

Look no further than the price of commodities (up by 19 percent between May 2020 and May 2021) to understand the severity of this disruption.

Many CFOs, COOs, and supply chain managers are scrambling to get a grip on their material costs and availability—but it won’t be easy. In a U.S. Census, Small Business Pulse survey conducted last year, 36% of small businesses reported delays with domestic suppliers; and the delays were highly concentrated in manufacturing, construction and trade sectors, helping drive double-digit price hikes.

Some price volatility is part of any recovery. But a confluence of factors (e.g., labor shortages, natural disasters, and the Omicron variant) has squeezed supply chains even further and sent prices spiraling upward. And it’s not over yet.

As they look at the coming year, savvy business leaders anticipate more substantial price hikes when it comes to raw materials like plastics, glass, and rubber. To preserve their margins now, suppliers are aggressively pushing their customers to reprice contracts, an unfamiliar game for most buyers due to the past decade’s pricing stability.

What you can do: KPMG clients are addressing these supply chain problems with a combination of different approaches: dual-sourcing, transparency requirements, indexing agreements, and more. But it all starts with getting a firm understanding of your firm’s weak points.

Consider having your Capital COE review your supplier contract and agreements and layout additions/changes they need to protect the company better. KPMG can help capture value and limit clients’ exposure in harmful situations.

More robust contracts create value because they put both parties “in the know” when adverse circumstances arise. This value can be determined/captured by fully understanding their contracts and any weaknesses these might contain. In addition, strong contacts can help prevent surprise increases from reducing EBITDA or material shortages resulting in more production downtime.

Your next steps:

1. Do our contracts guarantee supply continuity?
   Smart buyers add more performance guarantees in their supply contracts while also removing allocation clauses to mitigate the business damage of unforeseen, disruptive events.

2. Do we have ongoing price transparency for direct materials?
   Demanding ongoing price transparency is crucial. In volatile times, budgets often uncouple from actual prices, with disastrous results for profitability—and for procurement’s internal credibility.

3. Do we index our direct material costs?
   Indexing makes sense for the buyer when the supplier has limited ability to control the cost of materials, and those costs represent a high percentage of the buyer’s Cost of Goods sold.

4. Can suppliers meet our needs?
   Another commonly overlooked risk is failure to conduct due diligence on the supplier’s capacity and ability to scale supply. Whole sectors are currently being held back by commodity shortages.

Please download the KPMG report "When the price is wrong," for a more in-depth look at supply chain challenges as well as strategies to stay resilient in a chaotic market.

This is part one of a three-part series on pricing. Stay tuned for part two "How to Negotiate a Successful Price-Indexing Agreement," releasing later this month.

Click here for audio version
Contact us

Randy Fike
Deal Advisory, Managing Director
850-247-5888
rfike@kpmg.com

Eric Logan
Deal Advisory, Principal
216-875-8191
ericlogan@kpmg.com

Kunal Shah
Director, KPMG Consulting
847-372-8875
kshah3@kpmg.com