

PreScouter
2022

Top 3 Challenges **Procurement Teams Face**



Determining Economic Lot Size (ELS) and Inflation Factors

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Ideally, procurement teams are not responsible for financial policies, cost analysis and demand forecast.

Well-structured companies usually work with separate teams to provide guidance on these matters. This allows procurement teams to focus on their core responsibility: **NEGOTIATION** which entails finding the best option based on prices, quality, and timing. It is also not the job of procurement teams to determine the demand forecast.

The procurement team will decide based on the due diligence conducted by their financial team (financial policies + cost analysis + demand forecast) what are their best options considering how much is needed, under what agreements, and when to make the purchase(s).

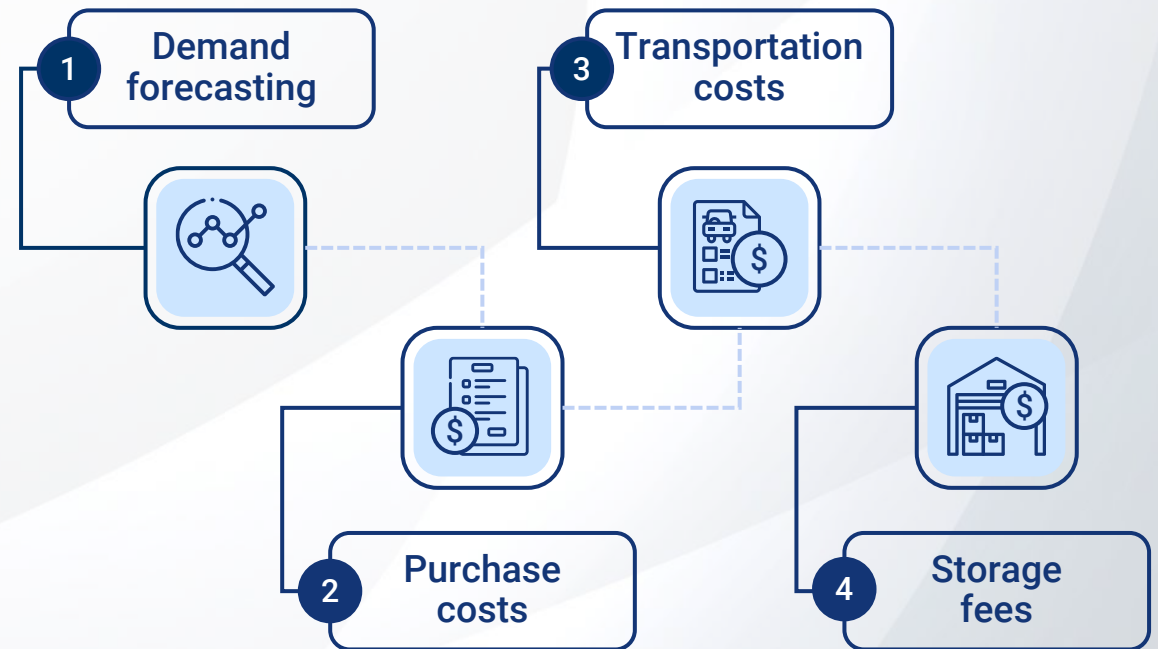


But this is not always the case as some companies do delegate these tasks to their procurement teams.

Strategic buying decisions require demand planning, financial policy reviews and cost analysis. Purchases should not be made considering only prices. Determining the economic lot size (ELS), i.e. the ideal quantity to purchase to reach the lowest cost possible, provides the basis for sound buying decisions from a strategic standpoint.

Large organizations invest a lot of money (and time) to understand these costs. And only with this in their hands, procurement teams can be more accurate in pursuing savings, cost avoidance, etc.

To determine the ELS, 4 main aspects must be considered:





Inflation is an additional variable that influences the ELS.

Costs are not constant and the “inflation variable” must always be considered.

The local economy interest rate mainly influences warehouse costs (which refers to what a company has in stock and thus considered investments).

Other prices will suffer from inflation, but such prices are usually protected by agreements previously made on contracts.

How do you put all the pieces together?

First, you must find a fair number to use as an interest rate to make estimates. These numbers are decided by the cost or financial department, not by the procurement team. Usually, the financial department chooses a rate that will protect the company against devaluation and provides some returns on investments (stocks) as well.

Second, you must find a "correction factor" based on the chosen interest rate, and the costs (already calculated) related to storage, transportation, and acquisition. This correction factor will be used every time you have to figure the ELS - the inflation is not a constant, so a company must choose a review period to re-check these numbers.



EXAMPLE STUDY

Material - Sugar



Annual forecast:
50 Tons

Possible options:

One-time purchase of **50 tons**

Two purchase of **25 tons**

Four purchase of **12.5 tons**

Six purchase of **8.3 tons**

Twelve purchase of **4.16 tons**

The bigger the batch purchased, the higher the costs related to storage will be. BUT, internal costs will be lower than making multiple purchases.

Is this the best option?

Understanding the ELS can provide a better understanding of which option is the best.

Let's pretend that we have those numbers previously calculated (i.e. costs + rates) and make a very simple comparison:

Inflation influences the costs related to procurement operations. When demand planning, financial policies, and costs analysis are in place, procurement teams can make the right choices. In this example, the challenge is selecting the ideal quantity.

	1 Purchase	2 Purchases	4 Purchases	6 Purchases	12 Purchases
Tons	50,00	25,00	12,50	8,30	4,16
Prices vs Tons	100,00	100,00	100,00	100,00	100,00
Acquisition costs	10,00	12,00	14,00	16,00	32,00
Storage fees	80,00	40,00	20,00	14,00	6,00
Total costs (without inflation)	190,00	152,00	134,00	130,00	138,00
Correction factor	1,00	1,50	1,65	1,75	1,85
Total costs (with inflation)	190,00	228,00	221,10	227,50	255,30

Notice how the ELS changes with inflation

Values are hypothetical



PreScouter's expert procurement teams can help companies fill this knowledge gap and provide the data needed to better understand and negotiate contracts.

PreScouter is enabling procurement teams to make more informed decisions.

Demand planning, financial policies, cost analysis, correction factors and interest rates are not the core business of procurement operations.

However, procurement teams need an ample understanding of all these factors to negotiate better contracts that will change the total acquisition costs (e.g. storage, transportation, administrative fees, etc.). For instance, with this data, contracts could then include reasonable clauses related to the "correction factor" for each cost type.

Supply Chain Challenges



Supply chains are continuously plagued by a number of variables and challenges, with transportation often being the most challenging.

From a global standpoint, international transportation is one of the most challenging issues in the supply chain process - even before COVID. After the pandemic hit, the prices of sea freights skyrocketed and the spaces for air freights were minimized.

As a result, some ships decided to “skip” a seaport due to unresolved problems, and companies ended up with their cargo being in a different port than what was planned. This further drove an increase in cost.



Top supply chain challenges in 2022



Fuel prices

increasing the
freight costs
(inbound and
outbound)



Inflation



Demand forecast



Congestion in ports



Shortage of labor and materials

The challenge is not only finding reasonable prices but also contracting agreements to ensure the spaces on ships and airplanes.

The contracts between the company and its vendors must include some specific clauses, such as load roll (depending on the agreements, the carriers can unload containers in any port to load another one - one that will bring more profit, for example).

Companies also usually dedicate time and money to Supplier Relationship Management (SRM) to ensure the continuity of agreements, constantly deliver quality, and proper price adjustments. This does not work (from a price standpoint) for commodities once their prices are not settled by the companies but by the market itself.



Hence, companies must always think ahead and anticipate the issues that could harm their supply chains.

The goal has always been to simplify the chain. This is not only a matter of cost savings but also risk management. For example, a complex chain implies higher chances of unforeseen demands, like a transportation accident. Many companies work alongside their suppliers to improve their methods and bring more security to the process (as a whole).

In summary, an excellent strategy to secure the company against issues that can harm the supply chain (causing cost increases and sometimes supply disruption) will usually intensely work with:

- KPIs controls (internal and external)
- Transportation (inbound)
- Risk management (supply chain)
- Supplier relationship management



Categories Management



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To ensure accuracy in the purchasing process, companies can create categories, or procurement towers.

This process consists of qualifying the purchased materials (spend analysis) and separating them into two main towers: **Direct materials** (part of the production) and **indirect materials** (support production operations). Working under categories often helps in the negotiation processes.



Benefits of working under categories



Force consumer decision-making at points of sale

Develop a strategy for differentiation and competition



Offer a collaboration model

Promote the exchange of information to improve decision-making



Provide greater strategic logic when making tactical decisions

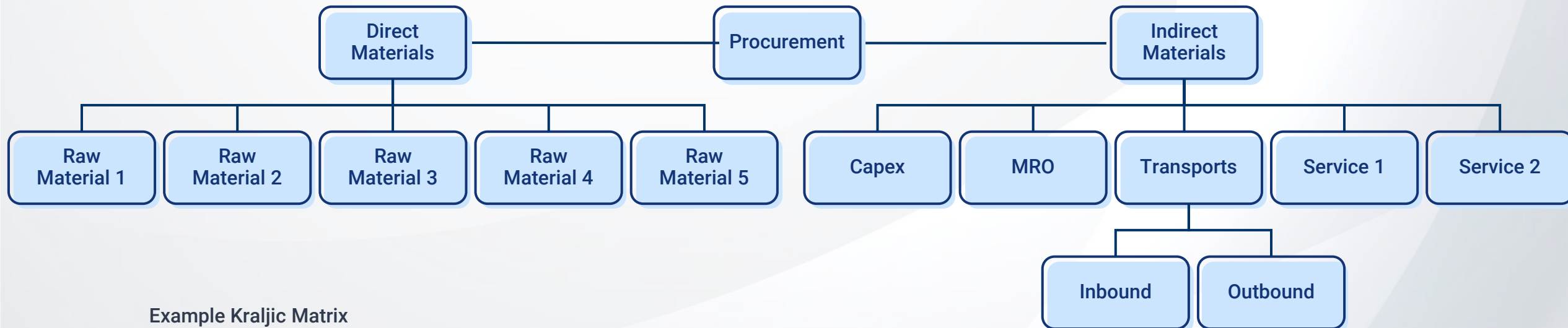
Clarify decisions about the allocation of assets and resources



Help further clarify employee responsibilities

The KRALJIC MATRIX is used for giving guidance on how to prioritize purchases. It's a balanced analysis between complexity and financial impact.

Using a KRALJIC MATRIX, teams can determine specific goals, actions, and procurement strategies for each category. The benefits of implementing this type of strategy will be seen as cost optimization, segmented top suppliers, management efficiency, and innovation.



Example Kraljic Matrix

PreScouter is partnering with procurement teams from around the globe to overcome these challenges.



Get in touch with our
Procurement Experts

solutions@prescouter.com



W.D. Shingleton

GE Healthcare

"The reason why I like to work with PreScouter is their almost relentless client focus on making sure they (and us!) understand what we do and do not want."



Avi Robbins

Porex Life Sciences Institute & AG
Industries, Filtration Group

"The technical depth at which PreScouter conducts their research is impressive, and the candid interactions with their teams are refreshing when compared to other consulting firms. Their team has guided us through important decision making processes that shape our business today."

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