How To Respond To Supplier Price Increases

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In today's world, getting work done means juggling tons of things at once. It also means relying on a lot of things we don't control. Did you know the average small business uses around 22 apps to get things done? That means if we're not paying attention to these fixed costs, alongside the pricing we offer to clients, we could seriously be putting a dent in our profitability, while also leaving money on the table.

That aside, it's important to think about what happens to your business when one of your mission-critical vendors decides to increase prices on the products or services you're using? How can you manage this with your customers so that you're not eating the majority of the cost increase?

When should you start price negotiations to negate the increases or at least reduce their impact on your business?

The answer may surprise some of you: you should have started negotiating when you originally obtained your current pricing. Always include this statement with your request for proposal (RFP): "Please include cost breakdowns for this product/service in your response to our RFP."

When you include this statement, make sure you also let your supplier know that by asking for this costing information, you're not aiming to take a bite out of their profit. Instead, you should emphasize that you're looking for ways to help them maintain the same, or even better profit levels while also exploring ways to reduce costs in the supply network.

With this approach, you're ensuring that the supplier can reach its financial goals while also maintaining market competitiveness as a result of the lowered or maintained price point.

Why is this pricing information so helpful?

Take, for example, a supplier who says they're going to raise your cost by 23% due to a 23% increase in the cost of aluminum last year. You'll be in a much tougher position to argue against the increase if you don't have the supplier's costing information. Communicating this upfront can help keep the relationship on solid ground in the future as you adjust to new pricing and payment terms.

> *When choosing vendors, consider not only the current price and the exchange rate, but also the potential for total cost increases in the future.*

Things to Consider When a Vendor Increases Price

There are a couple of things to consider whenever a vendor proposes a price increase. Mainly, you need to think about who or what is affected by the change. Then, you need to think about the steps your company will take in response to said increase.

Who or What is Affected?

If you have all your clients on a formal contract that details their service package that includes all vendor costs, you'll have a much easier time identifying the clients that are affected by a vendor price increase. If, for instance, all of your clients are affected by the price increase, that's a much bigger deal than if just one or two are.

What Steps Could We Take?

You have three options when a vendor increases their costs:

1. Absorb the difference.
2. Price in the changes.
3. Pass the difference on to the customer.

If the price increase is small and you can spread it across multiple clients, you may be able to absorb the price increase, so that your customers don't feel it at all. If you have been able to increase profitability elsewhere in your business, it also makes it easier to absorb smaller costs like this.

Another option is to price in an increase when you price your services. You can accomplish this one of two ways: don't pass on the full discount your vendor gives you if there's a vendor volume-based discount. Or, package your vendor costs into your service package with a margin. Pricing in changes makes your pricing more robust to change and gives you a bit of a profit margin if vendors' costs remain the same.

Your final option is to pass the difference in price onto the customer. This is usually the best option when the change is rather significant – too much for you to absorb, is client-specific, or the charge by the vendor means your clients have to accept a change to your terms and conditions. You'll pass the difference on to your clients with a contract scope change.

Negotiating in Response to a Supplier Price Increase

In procurement, it's no secret how important negotiation skills are throughout the supply chain. Whether you're negotiating with a supplier for the first time or trying to achieve a win-win solution after a price increase, there's a certain checklist you should follow.

Listen to What the Supplier Has to Say

It's quite possible that negotiations will be tense in the beginning. If this is the case, let the supplier vent. You win some bonus points with your show of empathy. This helps the supplier come around to rational business discussions. With the emotions out of the way, both parties listen better, which makes it easier to shift the conversation from feelings to facts. Always be genuine and authentic so that the supplier knows you're not trying to take advantage of them. The supplier needs to see you as reasonable.

Look Closely at the Bill of Materials

Spend some time reviewing commodity price trends. Separate each bill of materials (BOM) into material times. Many commodity prices are at all-time highs, especially metal and plastic. If your products are mostly metals, which metals? The increase should not be more than the historical movement for the specific metals in specific categories. The increase should not apply to portions of the assembly where prices have remained constant for months. Use the facts in your negotiations.

Separate All Your SKUs

Sort your product line into baskets. Segregate the increase to lower-volume parts where you likely have more margin to work with. Do your best to protect your high-volume parts where there is less of a margin to work with. Lock in your prices with a written contract, for as long as you possibly can. You want to avoid having to go back to the drawing board every time there's a price hike.

Adjust for a Temporary Increase

Similar to a gas surcharge in the transportation industry, carve out the price change as a separate line item. Keep your historical contracted pricing the same. Make sure the supplier knows you'll debate the topic from time to time to make sure everyone understands why the higher price needs to be kept a little longer or removed. Keep the discussion data-driven, and before each meeting ends, set the next review date.

Use Historical Data

Typically, Chinese suppliers don't do a lot of long-range planning. When they are hit with raw material increases, tariffs, etc, they don't necessarily have a plan to handle disruptions. They may even forget what they've committed to in a contract. Use the contract data to your advantage. If the conversation ever gets emotional, go back to the facts presented in the contract. Keep things fair, but fact-driven.

If it applies, remind suppliers of times when you took an increase and didn't ask them to share the burden with you. You may have absorbed a tariff on a specific product a few months ago. Use that to your advantage to get them to help you absorb plastic material cost increases. Remember, you're in a partnership, and everyone should share the burden.

Consider the Timing

Make sure you know when the pricing changes will go into effect. Sometimes, suppliers may argue that price changes go into effect retroactively, applying them to purchase orders (POs) that were shipped weeks ago. The increase should only apply to orders placed after a certain date, to give you ample time to adjust things and requote customers.

Explain Your Costs

Vendors will often overlook things like warehousing, marking, sales, order fulfillment, labor costs, and several other costs associated with bringing products to market. Transportation times and costs are higher than ever, and most deals are quotes in the port closest to the supplier. The brand owner has to take on all transportation costs and working capital during the transit time. Lead times are longer than ever before, so that means you're dealing with more of these costs than your existing supplier may realize. Make sure your suppliers know you're absorbing these higher costs, and you want a partner who will share the burden. Make them understand costs they don't see.

Share the News

If this is a major increase that has the potential to upset your customers, then let them know about the pressure you're dealing with. A single voice may not do much to keep prices where you need them to be. But, when you have an entire group of people talking with your supplier about the issue, there is a different impact. That puts more pressure on the supplier to do what they can to keep the pricing where you need it to be.

Prepare for several rounds of negotiations before you can reach the final mutually beneficial agreement. Remember, sometimes decisions aren't final so you must get the agreement in writing with clear instructions. Make sure the accounts payable team is up to date with the changes so that once the next set of invoices arrives. This way, they can confirm that everything that was agreed upon in negotiations is reflected in the invoice. Suppliers may try to get away with keeping things as they were, hoping that you didn't let AP know. (Not all of them will, but there are some out there who might.)

Though you may be tempted to tell your supplier you'll just take your business elsewhere, making switches like this are often unrealistic. Suppliers know this. That's why you must think about what that particular supplier means to your business, revenue, and bottom line as you approach every negotiation and price conversation.

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