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Buyers' Challenges in 2011

By Guest Contributor

In 2011, there will be new challenges and new opportunities for buyers. In this Expert's Corner, Mike Keating tells us what industrial purchasers can expect this year.

With economic activity in the manufacturing sector expanding in December for the 17th consecutive month, commodity price hikes are a big concern, according to the Institute of Supply Management's (ISM) latest [manufacturing Report on Business](#).

"Strong pressure still exists on raw material prices in almost every area," said a plastics and rubber products supply executive who serves on the ISM Report on Business survey panel. The report showed 27 commodities up and just one commodity down in price in the latest report.

Industrial buyers need to be aware of commodity price rises in 2011, says Gregory Weisman, chair of the Apparel Industry Practice Group at [Silver & Freedman](#), a business law firm in Los Angeles. "What's affecting industrial purchasers right now is the extreme increase and fluctuation in the price of cotton. It went up between 80 and 90 percent in 2010, and it impacted sourcing prices for apparel and footwear as well as their pricing at retail.

"We are seeing for the first time China drop from its peak as the pre-eminent sourcing partner, and manufacturers are scrambling to find other Asian countries where they believe they can get better pricing and source around some of the problems that they've had in China," according to Weisman.

Vendors in Thailand, Indonesia and Vietnam are being considered, not just as peripheral ancillary sourcing partners, Weisman says. "I'm seeing manufacturers start to do the bulk of their production in those three countries."

In 2011, industrial buyers need to watch for volatile pricing in a variety of commodities, including industrial metals, energy derivatives and agricultural products, says Ankur Goel, assistant professor of operations at the [Weatherhead School of Management](#) at Case Western Reserve University in Cleveland.

According to Goel, copper, platinum and palladium prices (the latter two are extensively used in the auto industry) "are already 80 percent above levels of 2009, so they can go down if the global economy sneezes."

To ensure cost-effective procurement, Goel urges industrial purchasers to incorporate price information obtained from commodity markets in their firms' procurement policies.

"Hedging commodity price risk, signing long-term contracts with buyers and suppliers, and getting better demand information are certainly some good strategies that buyers can use to ensure receiving the best value for the dollar," Goel tells IMT.

"Hedging is a good strategy, but with a caveat," Goel says. "If an industrial buyer can transfer the price risk to the price of finished goods, then he or she is better off not hedging. However, if due to market competition the commodity price risk can't be transferred to the finished goods, then it is better to hedge or sign a long-term procurement contract. Hedging is better for a short- to medium-term contract and should not be done for a very long-term contract."

But are commodity costs and prices everything in 2011? Lisa Anderson, a senior supply chain and operations executive, says procurement managers need to focus on more than commodity prices. Anderson, the founder and president of Claremont, Calif.-based [LMA Consulting Group](#), recently completed a survey of a dozen procurement executives on the keys to success in procurement.

Based on their responses, Anderson offered these procurement tips for 2011:

1. It's a relationship business. Thus, before focusing on any particular area such as cost, it is vital to spend the time on developing and fostering relationships.
2. As relationships are key, it isn't surprising that the one tip every interviewee mentioned was the importance of integrity.
3. Do not focus on cost; instead focus on total cost and customer results.

Purchasing executives need to work with their finance team to capitalize on recent federal legislation that permits companies, manufacturing operations included, to completely depreciate or expense the total value of equipment purchases in the current year, advises Andy Hammons, a principal in the Federal Income Tax practice at [Ryan, LLC](#), a Dallas-based tax services firm.

"The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 provides a 100 percent depreciation bonus for capital investments placed in service after Sept. 8, 2010, through Dec. 31, 2011. For equipment placed in service after Dec. 31, 2011, and through Dec. 31, 2012, the bill provides for a 50 percent depreciation bonus," Hammons explains.

The depreciation bonus applies to purchases of tangible personal property (including construction, mining, forestry and agricultural equipment) with a Modified Accelerated Cost Recovery System period of 20 years or less.

"While purchasing and expensing in the same year may provide a current-year benefit, it is at the expense of the future-year benefits. Additionally, for most companies, budgeting for large capital expenditures is usually done in August/September/October. It is questionable as to whether they would actually pull a purchase slated for 2012 or beyond into the current year," Hammons says.

Purchasing managers should note that cash reserve issues and the costs associated with making those reserves liquid may outweigh the benefit of the current year deduction, Hammons cautions.

"I would absolutely advise that purchasing managers take this knowledge to Finance (CFO, VP Finance/Treasury) as a great opportunity for a far better than typical Internal Rate of Return. Often, these purchasing managers will also win kudos for proactively bringing this forward. Internal tax personnel should be aware of this, but oftentimes are not involved in capital investment decisions," Hammons adds.

Industrial purchasers should tap their vendors for extras in 2011, says Cathy Williams-Owen, president and CFO for Port Washington, N.Y.-based [DriMark Products, Inc.](#), a manufacturer of writing instruments, security marking systems and inks.

One important trend Williams-Owen sees: "Buyers looking to vendors who will provide not only materials (or services), but also valued-added options. For example, a chemical company we purchase raw materials from assists us in compliance training, product testing and other areas. Using the expertise of their vendors will save buyers time and money."

One last tip: Purchasers should consider attending ISM meetings to stay up-to-date on 2011 market conditions. The [Atlanta ISM affiliate](#), for instance, recently staged a

professional development session, "How is U.S. Manufacturing Weathering the Financial Storm?" On Feb. 10, the affiliate will hold a session called "Leveraging Strategic Supplier Relationships to Extract Real Value."

*Michael Keating is senior editor for [Government Product News](#) and a contributing editor for [American City and County](#), both published by Penton Media Inc. His [complete 2011 government budget forecast](#) is available at [GovPro.com](#). Keating has written articles on the government market for more than 100 publications, including *USA Today*, *Sanitary Maintenance*, *IndustryWeek* and the *Costco Connection*. Mike can be reached through his website, [MikeKeat.net](#).*

