

Contract Purchasing: Overcoming Inflation and Exchange Rate Variability

Emphasizing the need to take a comprehensive approach.

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1. INTRODUCTION

During the period between 1970 and 2000, inflation experienced considerable fluctuations worldwide. In the 1970s, inflation was particularly high, reaching its peak in 1979 with an average annual rate of 13.3% in the United States and even more in some European countries. In the United States, for example, inflation was driven by high energy prices, wage increases, and expansionary monetary policies. In the 1980s, inflation significantly decreased, but remained relatively high in many countries. Since the 1990s, inflation further decreased, and this trend continued in the early 2000s, although there were some exceptions, such as the 2008 financial crisis, which led to an increase in inflation in many countries.

Inflation had significant consequences for various sectors of the economy, including the purchasing contracts of public administrations because contracts could become obsolete quickly, as the purchasing power of money decreased rapidly.

The reduction in inflation during the 1990s and early 2000s was a result of various factors, including the adoption of sound macroeconomic policies by many countries, the introduction of new technologies that increased productivity and reduced costs, and the opening up of global trade and investment. The decline in inflation led to greater economic stability, lower interest rates, and higher levels of investment and growth.

However, the 2008 financial crisis had a significant impact on inflation, as many countries implemented expansionary monetary policies to stimulate their economies, leading to an increase in prices.

To address this issue, public administrations and companies had to adopt various measures, including escalation formulas, to ensure that purchasing contracts remained fair and viable despite inflation. These formulas typically involved adjusting prices to reflect changes in inflation rates over time. By using these formulas, public administrations could more accurately predict costs and ensure that contracts remained viable for their duration.

A comparison between the inflation of the period between 1975 and 1985 and the inflation of 2022-2023 reveals some notable differences. In the 1970s and early 1980s, inflation was a major problem for many countries around the world, with some experiencing double-digit inflation rates. In the United States, for example, inflation reached a peak of 13.3% in 1979. During this time, many countries implemented policies to combat inflation, such as raising interest rates and tightening monetary policy.

In contrast, the inflation rates of 2022-2023 are currently not as high as they were in the 1970s and early 1980s. However, inflation has been on the rise in many countries, including the United States and some European countries. The causes of inflation today are different than they were in the 1970s and 1980s, with supply chain disruptions, rising energy and commodity prices, and labor shortages contributing to the inflationary pressures. Central banks are currently taking various measures to address the inflationary pressures, such as tightening monetary policy, increasing interest rates, and reducing stimulus measures.

Exchange rate variability was another challenge faced by public administrations during this period. The value of different currencies fluctuated wildly, making it difficult to conduct international business and establish fair prices for goods and services. As a result, formulas were developed to account for these fluctuations, allowing contracts to be established based on current exchange rates while also accounting for potential changes in the future.

Inflation and exchange rate variability were significant challenges faced by public administrations in the 1970s and 1980s. However, by adopting various measures and formulas, such as escalation formulas and exchange rate formulas, public administrations were able to establish contracts that remained fair and viable despite these challenges. With the creation of the Euro, these challenges were largely overcome, paving the way for greater economic stability and predictability.

To contain the effects of inflation, which is a widespread phenomenon that simultaneously affects many components of the economy, numerous practices can be adopted. However, to be effective, these practices must be incorporated into a comprehensive sourcing strategy capable of

measuring their individual impacts and balancing their use to ensure optimal overall results. Such a global and complex scenario requires procurement functions to use essential, adequate computer tools to govern and cross-reference the data generated by individual practices, extract information, provide suggestions, and provide an informative framework to make solid and informed decisions.

2. SITUATION TODAY

The current economic situation where inflation is affecting supply chains and the entire corporate supply chain is experiencing complex impacts. This inflationary regime is attributed to the post-pandemic recession, supply chain shortages, and geopolitical instability. These factors have led to a situation where inflation has risen to an extraordinary level, creating an extremely difficult economic situation.

The impact of inflation is not limited to specific goods and services but has far-reaching effects on the entire supply chain of a company. It affects the supply chain from procurement to the market outlets, making it difficult for companies to manage their operations. The passage highlights the importance of understanding the broader impacts of inflation on the entire supply chain and its complexity.

3. HOLISTIC APPROACH

The topic at hand requires a more holistic approach that needs to be framed within a broader context of corporate behaviours that, if virtuous, can form a solid and resilient foundation.

When it comes to purchasing during times of inflation, it is crucial to take a more comprehensive approach that considers the broader context of corporate behaviour. This means that purchasing decisions should be informed by a deep understanding of how they fit into the larger picture of the organization's operations and strategic goals.

Rather than just focusing on a specific aspect or component of this behaviour, a more holistic perspective is needed is suggested. By considering the broader context in which these behaviours occur, it becomes possible to identify patterns, connections, and interdependencies that may not

be immediately apparent when looking at things in isolation. This can help to develop a more effective and resilient approach that is better able to withstand potential challenges and disruptions.

Inflation can impact purchasing decisions in various ways, such as price increases, supply chain disruptions, and shifts in demand. Therefore, it is essential to consider the full range of factors that may be influencing purchasing decisions, including those that extend beyond immediate costs. This requires a more holistic approach that takes into account the organization's overall strategy, values, and goals. By doing so, organizations can make more informed decisions that align with their strategic goals and values, while also building a solid and resilient foundation for the future.

4. RECOMMENDATIONS

In times of inflation, it is important for companies to adopt effective purchasing practices to mitigate the impact of rising costs.

1. A **Systematic Cross-Functional collaboration** with shared decisions involving the entire business strategy, an adequate level of digitalization to manage the entire procurement process in an integrated manner characterized by high volumes of data with their connections and dependencies, a systematic analysis of the company's product categories to constantly have a clear understanding of their relevance and exposure to market forces.

In this context, the adoption of appropriate and harmonized practices in a strategic sourcing plan can create a solid framework to protect and respond: optimizing resources, identifying the most suitable suppliers, leveraging market opportunities to contain costs and safeguard quality, ensuring stable and reliable supply.

2. One purchasing practice to mitigate the impact of rising cost is the **Total Cost of Ownership** approach, which considers all costs associated with purchasing a product or service, including transport, installation, operation, maintenance, and disposal. This approach allows for a comprehensive evaluation of the true cost of a purchase and helps companies make informed decisions regarding their procurement strategy.

3. Another important practice is the **Detailed and Systematic Analysis** of procurement spend. By understanding what has been purchased, from whom, at what cost, and in what quantity, companies can better identify which areas of their procurement process are most vulnerable to the effects of inflation. This, in turn, allows for more targeted market analysis and price trend forecasting, which can inform purchasing decisions and help companies protect their production processes from supply chain disruptions or further inflationary pressures.
4. **Knowledge of spending** also facilitates the practice of grouping to benefit from economies of scale, have greater bargaining power to contain inflation-driven increases, and make the procurement process less burdensome due to the fewer contracts to manage.

Technology can help procurement departments to effectively implement these practices and strategies. These technological tools can provide a central repository of information, such as supplier data, transaction records, and contract terms, allowing procurement teams to analyze data in real-time and make informed purchasing decisions. Additionally, these tools can help identify cost-saving opportunities, streamline procurement processes, and improve supplier relationship management.

5. CONCLUSIONS

Overall, the effective management of procurement in times of inflation requires a strategic approach, incorporating a range of practices and tools. The use of technology can be particularly beneficial in this regard, helping procurement teams to stay on top of market trends, analyse data, and make informed decisions that support the business's overall goals.

By adopting these practices, national organizations and companies can optimize their procurement processes, mitigate the impact of inflation on their bottom line, and maintain stability in their operations.