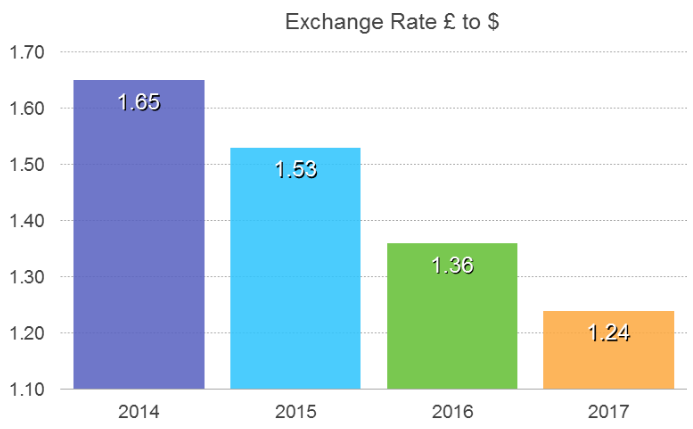
ACHIEVING A PRICE INCREASE DURING TIMES OF CURRENCY FLUCTUATIONS

After the events of last year, exchange rate fluctuations have had a dramatic effect on the cost of goods into the UK. As a result I have had a number of suppliers ask me for advice on what strategies can be implemented to help the situation.

I have outlined in this paper some thoughts and practical solutions on how to work through these situations.

The fluctuations in exchange rate of the £ to the $ has a reasonable cycle to it, a little like a wave, with peaks and troughs occurring in a regular pattern. 2016 was already a low point in this cycle and the events of last year took the exchange rate to an unprecedented low level.
Over the past 3 years we have seen annual averages drop from 1.65 in 2014 to 1.53 in 2015, but the turbulent 2016 moved the average in the first half year from 1.43 down to 1.28 in the second half year giving the annual average of 1.36. So far in 2017 the average has been 1.24.



The problem at hand

A large percentage of product sold in the UK comes either directly or indirectly from Asia, so fluctuations in the exchange rate is a major factor on the cost of goods. These significant fluctuations will impact consumers, retailers, suppliers and even the UK's macro- economic situation. The UK economy relies heavily on retail sales, with it contributing over 5% to our GDP, so how we approach the problem is critical.

Disaster I hear some of you shout, a more hopeful "it will get better soon" from others. Well even the most optimistic currency hedgers I have spoken to say it may climb to a 1.35 at some point this year but as we manage risk in our businesses we need to assume that even this may not happen. Some are predicting that we will reach a point of parity with the dollar!

If you source product from Asia and supply it domestically. You will be feeling the pain of the current exchange rate and will be looking for price increases with your retailer customers, so you can protect your margins.

If you source product from Asia and supply it directly in containers from your factories. In this scenario as your cost prices with your retailers are in $'s, it is the retailers who are feeling the impact of the exchange rate fluctuations. You may already have retailers requesting cost reductions to mitigate this impact already.

Finding a solution and the way forward

A strong working relationship is key. In times such as these you can easily destroy your relationships. There is also the opportunity to develop new and even stronger working relationships with your retail customers through a collaborative way of working.

Don't be surprised if a Buyers starting point is to avoid your calls, not answering your e-mails or more blatantly just refusing to discuss price increases. It is an unwritten rule in a Buyer's job description that they should not agree any actions that negatively impact their Company's profits, and accepting price increases without reflecting these changes in the retail price will obviously do this quickly.

Traditional negotiation methods are a thing of the past. Hi-low negotiations where you expect to agree and compromise in the middle ground of your starting position are wholly out of date. It is time to be thoughtful in your approach and outline a robust position with strong justification on why prices need to change. You need to demonstrate that you are doing your part in mitigating the pressure on costs.

Think carefully about the strategy you will adopt. Your starting position is critical and consider the level of seniority you need to engage with in addition to buyers. Be prepared to talk through the detail of what you are doing about the issue and the pressure you have put on your own business to avoid price changes.

Do not underestimate the work that is required here in this exceptional situation where retailers are already being vocal and ready to reject requests for cost increases. Getting the negotiation right first time is critical here for your own reputation as well as securing a fair result.

Tell the story of what has happened with your cost of goods. Go back to when you last set pricing and map out the flow since then. for example:

- When did you last set the pricing and how long were the prices due to last? Do you have any committed terms in place. Whilst this may well not allow any changes, as you would not want to go back on an agreement, you can still use the current situation to highlight the issues the current pricing is causing and would act as a heads up for future discussions.

- Did you agree any metrics at the time that would automatically trigger a change in prices such as Raw Material changes or exchange rate fluctuations? If you have them in place can you use them now?

- What was the exchange rate when you last agreed pricing and since then what is the net effect of all changes? If you have had a period where you benefitted, then pre-empt this and be transparent and open about the gains and losses you have incurred and these need to be reflected in your discussions.

- What has changed in terms of cost of manufacture, such as labour rates since you last set prices? We all know that labour rates in China have increased dramatically over the past 5 years but think carefully how this has impacted the cost of your product. Making a big thing about this will back fire on you if it has only impacted the cost of the product by small amount.

- What has changed in terms of Raw Material fluctuations. In the same way you have tracked exchange rates, work out the net effect since you last set pricing. Also take the opportunity to talk about future trends giving better visibility for you both. Ensure you are prepared to justify the impact on your products through a breakdown of raw material fluctuations by product if required.

If you can justify an increase remember a reduction in retailer profit margins is likely to trigger cost reduction activities with your retailer such as a reduction in headcount or reduced investment in other growth initiatives. So, don't take the situation lightly and make sure you demonstrate that you have looked at efficiencies from your side, such as:

- Show how you have scrutinised your ranges and products, through value engineering, to look at efficiencies such as the removal of over engineered product specifications that may not be required by the consumer. You could also take a category management approach with your retailers and work with them to value engineer an entire category by benchmarking the competition on price and product specification to ensure you have an optimal range to meet consumer requirements.

- Demonstrate you have put pressure on your factories to deliver savings.

- Chinese factories have benefited from the exchange rate of USD to RMB so show how you have taken these savings into consideration. Over the last 18 months the rate has moved from 6.20 to 6.90 giving the factories a 10% benefit in currency across the period.

- Give the retailer some confidence about the future. Offer up a set of circumstances and criteria when cost prices would automatically change, and by that I mean reduce, without the need for long negotiations or a requirement for the retailer to prompt you. You could set the exchange rate, and even set the price for some of the key Raw Materials, and then agree a set of criteria that would trigger an automatic price change. So that prices are not changing too often I have found setting a fluctuation level of 2% a reasonable position, so if any of the set criteria change by more than 2% then prices will move. This type of agreement will also protect you if the situation worsens and a further price increase is required.

- Demonstrate where you have implemented efficiencies in your own operation for example in your supply chain, through reductions in premises and travel or staff costs. If you expect the retailer to take a reduction in profits which would force them to look at efficiencies in their business, then it is reasonable for you to do the same.

- You could ask for incremental business in another product area or with a new range but I would note a word of caution here. This potentially can delay the inevitable as it does not deal with the issue though it can be useful to give you time to be more creative and work out solutions, but recognise that this is not a long-term fix for the situation.

The final status

If the retailer cannot accept your cost increases, you have some options: continue to supply or do not. Remember the pressures the retailer is under in the competitive landscape so increasing retail prices may be very difficult, and with the pressures from their stakeholders a reduction in margins could be seen as a weakness in the management and commercial teams.

If however you are going to continue to supply product without having secured an increase at least take the opportunity to highlight the issues it may cause, for example:

- A reduction in your profits may impact on how you service the retailer.
- Highlight the added value elements you currently perform that you may not be able to offer in the future.
- A potential reduction in investment in New Product Development which we all know is the lifeblood of successful long-term retailing.

Take the opportunity to make some requests, such as:

- Get some commitment that if the situation worsens then you have an agreement to come back to the table based on Raw Material and exchange rate fluctuations.
- Ask for 1st refusal on new product listings
- Priority on promotional lines and opportunities
- Incremental advertising opportunities and better locations in store

If the retailer does accept the cost increase but states it will all be reflected fully in the retail price to maintain their margins, be aware of the implications:

- An increased retail price can potentially open the door to your competition and allow them to get a step ahead of you

- Volumes will likely be reduced through higher price points, remember it is the consumer that decides afterall. Not only is this likely to impact on your cash generation but it may also impact on your cost prices with factories.

In all your conversations make sure you keep the consumer in mind. Demonstrate to the retailer that you are not just thinking about your own business but theirs and what the impact will be on the end consumer because of the changes.

As you interact with the retailer take the opportunity to talk about your business, what you have planned, your developments and importantly your point of difference. Remember that you may not have had an opportunity to do this before.

Finally, make sure every member of your team takes a professional approach to the discussions even if they get frustrated. If you can avoid taking an aggressive position as I have never found this to be a fruitful approach in the long run. Take a multi-level approach to discussions, interacting where you can with various levels of management with the retailer. Raising the awareness with the senior team of the steps you are taking to mitigate increases is more likely to get a positive result and at worst will show your professionalism and integrity as a key supply partner.

If you have any questions or would like help with what can be tricky negotiations and discussions,* please do not hesitate to contact me at** clive@mdj2.co.uk, ***or call me on 07515 000643.

Clive Daley

Clive has 30 years' experience in retail, sales and purchasing. He has held all major roles in the retail commercial function including senior roles for companies such as John Lewis, DSG (Dixons/Currys), B&Q and Superdrug.

He was the MD for 5 years for a major Chinese manufacturer in the DIY sector and was then CEO for a Global Distributor.

Clive is now a business advisor and forms part of mdj2 associates team who are retail experts. He now helps businesses optimise their trading and get more done. He also supports them through an "In-flight Service", which is a "when you need it" commercial support service, and through strategic Business Boot Camps where business teams take time to focus on goals an work out how to effect great change and deliver results.

His expertise covers Commercial, Negotiation, Purchasing and Business Development and he has a key insight in working with China and the rest of Asia.

For more information on mdj2 and how we can support your business

visit our website