THE ECONOMY ISSUE: CURRENCY FLUCTUATIONS | CONTRACT NEGOTIATIONS | FUEL SURCHARGES

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UP AND DOWN

How can supply chain professionals cope with the currency roller coaster?

By Heather Hudson

If death and taxes are the proverbial certainties of life, currency fluctuations are one of the things you can count on in business.

Over the last five years, the Canadian dollar has been as high as parity with the U.S. dollar and as low as 78 cents/USD. These fluctuations often mean the difference between profit and loss for businesses operating on slim margins. And they can be a primary source of stress for supply chain professionals.

Diana Gavrila, procurement director for The Allan Candy Company Ltd. in Granby, Que., says she's seen suppliers resort to everything from instituting a price increase to cover the cost of currency fluctuations to levying exchange rate surcharges to asking to be paid in USD.

"As soon as the U.S. dollar started to be stronger, our suppliers who buy packaging in USD had to react – their margins were going down," she said. "We try to meet our suppliers halfway as much as possible, but it is a challenge."

Below are proven strategies to help supply chain professionals mitigate the risks associated with currency fluctuation.

SECURE FIXED PRICING

"One of the first things I do is try to fix firm pricing for the life of the contract. In public procurement that's the norm, but it may require negotiation in the private sector," said Nikki Raycraft, manager of strategic sourcing for Medbuy, a London, Ont.-based group purchasing organization in the healthcare industry.

With fixed pricing, you're immune to currency fluctuations and better able to forecast and budget. When fixed pricing for a long-term contract is not in the cards, Gavrila will scoop up some product at a fixed price.

"We started to hedge foreign exchange risk by buying spot contracts at fixed exchange rates. This is protection from fluctuation, but you have to consider that if it goes the other way and it's a positive fluctuation, you can't benefit from it," said Gavrila.

"It's worth it for some commodities, like ingredients, coming from the U.S. It's still good to buy a fixed amount and then the supplier would produce product for you in advance and keep it for you like a vendor management inventory."

GO QUARTER BY QUARTER

The opposite approach to securing fixed prices can also be advantageous. When prices went down in the third and fourth quarters of last year, Gavrila was pleased with the decision to buy quarter by quarter.

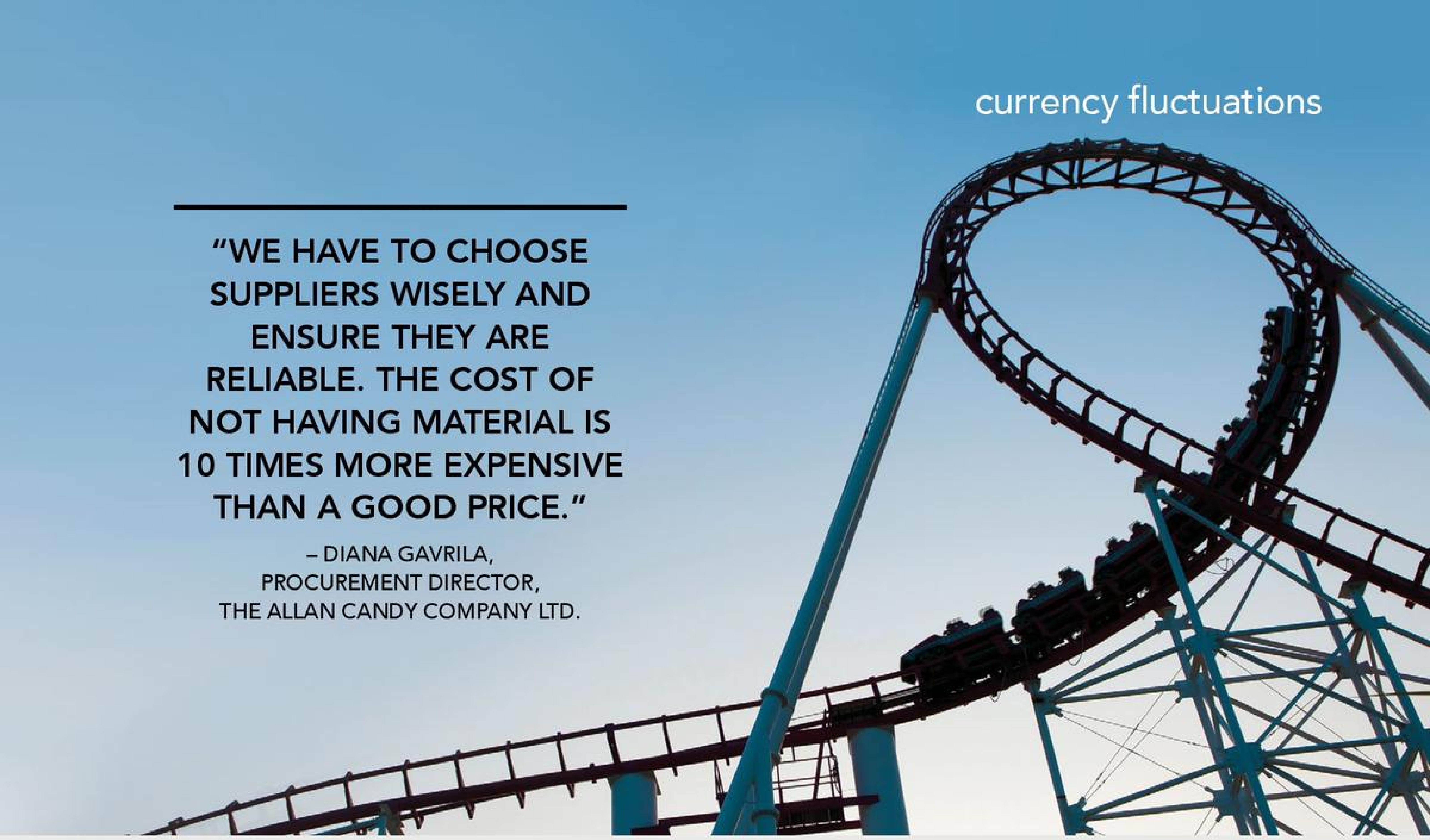
"It was a good strategy because prices were going down. This year is slightly different so we've tried to [lock in contracts] that go to year end."

This strategy requires closely consulting the economy and market trends, but it can pay off when prices drop due to a low demand.

INCLUDE AN ESCALATOR CLAUSE

A typical escalator clause will stipulate that if the currency fluctuates greater or less than a certain threshold, the buyer and seller will meet to negotiate the impact of pricing for the future.

This protects both parties from rapid swings. Raycraft recommends employing a widely accepted index such as Pro Purchaser to validate the price changes and level the playing field.



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THE ALLAN CANDY COMPANY LTD.

USE CANADIAN SUPPLIERS

It's not always possible, but working with local companies means you may not have to worry about currency fluctuations.

"It's very rare to see 90 per cent of the cost in Canadian dollars, but looking for Canadian manufacturers is a viable strategy in terms of not having to worry about currency fluctuations," said Raycraft, who also teaches supply chain management at Fanshawe College, in the Richard Killen School of Business and for the Supply Chain Management Association (SCMA).

"A lot of times, it's worthwhile to work with smaller to medium companies, which may mean logistics costs are less. These partnerships help manage a different type of fluctuation," she said.

HEDGE DOLLARS

Insisting that your suppliers hedge U.S. dollars is a no-brainer. They secure a special rate that protects them from spot rate fluctuation and you get the best price possible.

"It's very common for larger corporations to have a U.S. funds account and buy U.S. funds in Futures at a reduced rate," said Raycraft. "It's risk mitigation for both the buyer and the supplier. The last thing you would want is for a lagging currency to have a negative impact on your supplier and put them out of business."

She recommends ensuring your company hedges U.S. funds as well.

CHOOSE SUPPLIERS WISELY

Like anything in life, if something appears too good to be true, it probably is. You might think you've stumbled upon a dream supplier if they're a Canadian company dealing exclusive in Canadian dollars and at low prices, but Gavrila cautions that you can't put a price on a good partnership.

"We have to choose suppliers wisely and ensure they are reliable," she said. "The cost of not having material is 10 times more expensive than a good price. In fact, price is only a small part of the relationship with your supplier. Everything else has to make sense, too."

Raycraft agrees, emphasizing the importance of being educated before meeting with a supplier.

"When I'm going to market for a procedure tray, I know there will be specific components that are part of that, and what the cost of each of [those components] is, including sterilization and transportation, etc.," she said. "So when a supplier offers me their pricing, I'll know whether I can trust it based on my research. Anything higher or lower will be a red flag… having the information at the outset helps me know what is fair."

MAINTAIN GOOD RELATIONSHIPS

Once you've established good working relationships with suppliers, it's critical to maintain them.

It's good business practice to understand what cost changes mean for your suppliers and help them the same way you would [help] your organization with strategies to mitigate impact, says Raycraft.

"Don't wash your hands of things that may be thought of as suppliers' concerns," she said. "A supplier who knows that you're invested and understand their challenges and are there to work with them will be more interested in being fair and transparent with you."

Managing currency fluctuations will always be part of a supply chain professional's work. How to cope with them is up to you.