

PRIVATE EQUITY EXECUTIVE SERIES

Diverging Trends: How A Buyer's Market Emerged Behind Record Inflation



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HAS A BUYER'S MARKET BEEN BUILDING IN THE SHADOW OF INFLATION HEADLINES?

Since the start of the pandemic, the message has been consistent: shortage of supply is increasing prices. From semiconductors, to labor, to ocean freight containers, supply-driven inflation is all around us. We are reminded every month when the Fed updates us on inflation, which hit a 41-year high in 2022, or when we visit a local restaurant with a “Help Wanted” sign.

However, another set of headlines is beginning to enter the front page. With a recession looming, demand falling (retail sales fell in December), and inflation posting improvements each month, what can we expect in 2023?

We see three key trends emerging:

1. The Bullwhip Effect has put some spend categories on a fire sale
2. Drop in demand has brought categories back down to earth
3. Tight labor markets and rising energy costs will continue driving inflation in some spend categories

Keep reading for our detailed **Sourcing Market Heat Map** which will help executives today navigate a complex global economy.



SECTION 1: THE BULLWHIP EFFECT: SOME GOODS ARE ON A FIRE SALE

“Why is everything on sale? The bullwhip effect” – WSJ

“All Those Real-Economy Pandemic Price Surges Are Going in Reverse” – Bloomberg January 2023

The COVID pandemic sent shockwaves through the supply chain in ways only documented in graduate school simulations. After much of the world began reopening in 2020, the consumers thirst for goods was met with empty shelves and inventories, leaving companies scrambling to secure supply and satisfy unmet demand backlogs. The result? Skyrocketing prices, lead times increasing on every order, and on-time fulfillment became a product of luck instead of careful planning.

The vicious cycle of increasing orders, causing bigger shortages, is known in supply chain as the Bullwhip Effect, and in some cases it reverberated for months, even years. The result is no surprise – goods or services in high demand and short supply, such as semiconductors, lumber, and transpacific transportation, skyrocketed in price.

What happens when demand does not persist? Suppliers are left placing excess goods into inventory resulting in a precipitous drop in prices.

Remember the semiconductor shortage of '20-'22? The 'pixie dust' necessary to run everything from cars to personal computers was in short supply for the last three years. However, according to a UBS Analysis, semiconductor inventories just hit their highest level in a decade, with median producer inventories nearing 40 days. Hewlett Packard CEO said in a December earnings report: “Today we have a large inventory, especially on the consumer side, which is driving very aggressive pricing because all of us are trying to reduce those inventories.”¹

SECTION 2: DROP IN DEMAND LEADS PRICES DOWN

AN EXAMPLE FROM THE FREIGHT MARKET

Drop in demand is another driver in easing markets for 2023. As consumer spending and sentiment remains poor with a looming recession, keep an eye on all markets to either crest or begin to fall in 2023.

The transportation industry has long been a harbinger for the economy. The elevated prices in 2020 were an early indication of the intense inflation that would eventually engulf the world. Falling prices in 2022 and into 2023 point to reduced production and trade.

How about the famous Ocean Freight market of 2021 and Q1 2022? We all remember pictures of up to 40 vessels waiting to enter LA-Long Beach port – that queue is completely gone as of November 2022.

In September the port of Los Angeles processed 709,783 TEUs, down 21% YOY.² The result? The cost to move a container from China to US West Coast peaked at over \$20k in September 2021 and dropped to \$1,300 in February 2023, a 93% drop, according to Freightos.³

Ocean freight isn't the only mode of transportation falling off a cliff. Truckload is a market dominated by small businesses with a few power units. High pricing in the past few years attracted new entrants. Recent drop in demand has sent prices falling; we have seen up to 25% year-over-year savings from competitive sourcing.

1. <https://www.wsj.com/articles/chip-inventories-swell-as-consumers-buy-fewer-gadgets-11672092605>

2. <https://labusinessjournal.com/featured/port-congestion-finally-clears-up/>

3. Freightos: <https://fbx.freightos.com/freight-index/FBX01>

PRODUCTION DROP CAUSED COMMODITY MARKETS TO COOL

“..of the 18 tracked manufacturing industries, only one reported growth in new orders and 14 reported a drop in new orders” – Institute for Supply Management December 2022

Lumber, steel, and resin are three key commodities which were highly constrained during the pandemic but have radically changed course towards a buyer’s market.

LUMBER

- Lumber prices hit a 10-year peak in Q2 2021 before shooting up again in H1 2022
- Over the tail end of H2 2022, lumber prices have finally begun to soften
- We can expect wood-based products to reflect this commodity trend, indicating a future softening for pulp, paper, and most goods made from lumber

STEEL

- Steel was one of the first commodities to shoot upwards at the height of the pandemic
- After increasing in the tail end of Q1 2022 and early Q2 2022, cold and hot rolled steel has been on a steady drop down to current market conditions
- With new service centers opening up across North America, capacity is expected to continue to increase, providing much needed relief on steel pricing

RESIN

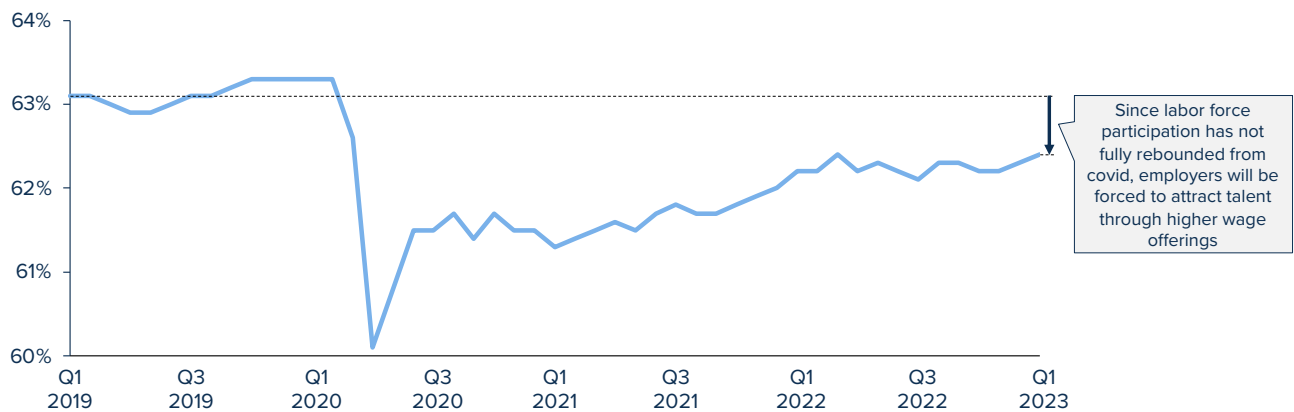
- North American Blow Mold HDPE and Polypropylene Homopolymer peaked in Q1 2021, but was slow to fall over the remainder of 2021
- Polypropylene Homopolymer pricing fell 40% in the last eight months

SECTION 3: LONG TERM INFLATIONARY PRESSURE: TIGHT LABOR MARKETS AND RISING ENERGY COSTS

Falling commodities has provided relief in many markets, but not everything is on sale.

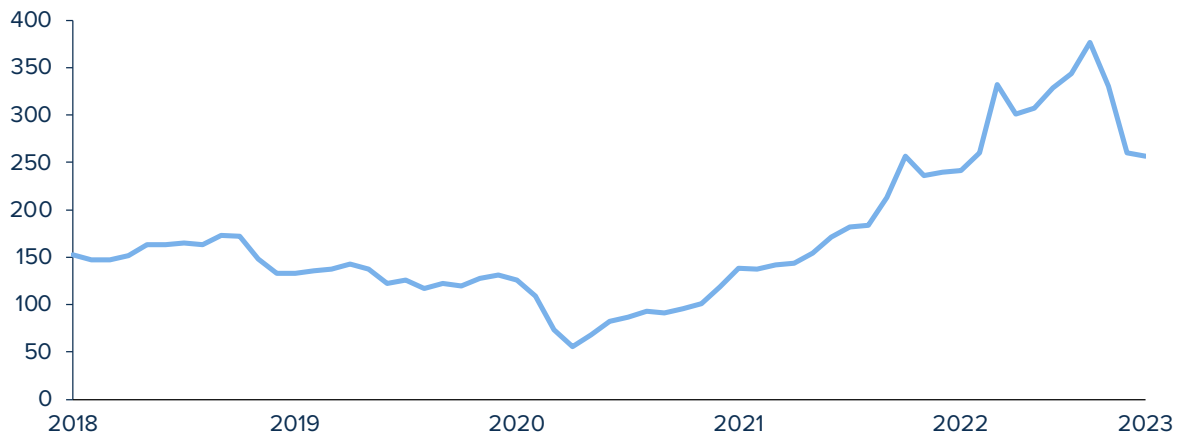
Labor force participation rate, the number of people in the labor force compared to total population rate, is still below pre-pandemic levels. Individuals left the labor pool in the pandemic and many did not return, driving a tighter labor market with 50-year record low unemployment rates. As of February 2023, there were twice as many job postings as available job seekers, potentially indicating ‘full employment’ of the economy until labor force participation returns. With these dynamics in the labor market, wage inflation will impact categories most sensitive to labor cost inputs.⁵

Labor Force Participation Rate



Energy costs have skyrocketed as well, and while there has been some relief since highs achieved in the first half of 2022, energy costs are still over 2x the cost pre-pandemic (November 2022 vs. Jan 2020 is +104%).⁶

Global Price of Energy Index



5. https://www.wsj.com/articles/jobs-hiring-boom-layoffs-employment-11675947399?mod=search_trending_now_article_pos1

6. Labor Force Participation Rate Graph: U.S. Bureau of Labor Statistics, Labor Force Participation Rate [CIVPART], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/CIVPART>, February 9, 2023.

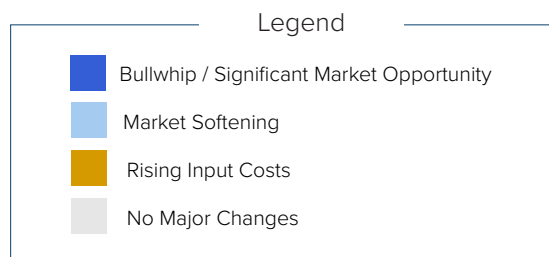
7. International Monetary Fund, Global price of Energy index [PNRGINDEXM], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/PNRGINDEXM>, January 6, 2023

PICK YOUR TARGETS CAREFULLY TO MAXIMIZE SAVINGS IN 2023

Insight Sourcing Group has been helping our clients navigate this complex global economy. Informed by hundreds of sourcing projects in today's rapidly evolving market, we've developed a perspective on each major category.

Sourcing Market Heat Map

Raw Materials	Equipment	Information Technology	Real Estate & Facilities	Logistics	Human Resources	Supplies	Packaging Products	Marketing	Professional Services	Food & Beverage	Corporate
Bulk Chemicals	Switchgears	Value Added Resellers	Facility / Property Rent	Truckload	Contingent Labor	Janitorial Supplies	Corrugated	Marketing & Advertising Agencies	Legal Services	Poultry	Office Supplies
Resins	Generators	HW Purchase & Maintenance	Building Construction	Ocean Freight	Recruiting	PPE	Pallets & Crates	Media Buy	General Consulting	Dairy	Corporate Insurance
Paper Products	HF Chillers	IT Consulting	Electronic Security	Air Freight	Payroll Processing	Pipes, Valves, & Fittings	RFID Equipment	Market Research	Accounting & Audit	Fats & Oils	Worker's Comp
Steel	Forklifts	Voice & Data	HVAC	Less-than-Truckload	HR Consulting	Adhesives, Sealants, & Tapes	Barcodes & Labels	Digital Marketing	Risk & Compliance	Beef & Veal	Employee Insurance & Benefits
Other Base Metals	Cranes	Wireless	OFM	Small Parcel	Executive Search	GIS	Paper Cores	Events & Trade Shows	Contact Center	Eggs	Medical Insurance
Lumber	Trucks & Trailers	Cloud Services	Janitorial Services	Rail	Corporate Conferences & Events	Equipment Maintenance & Repair	Foam Products	Media Production	Corporate Insurance	Soybeans	Investor Relations
Rubber	Packaging Equipment	Data Storage	Waste Disposal	Warehousing	Background Checks & Drug Testing	Quality Inspections	Bags & Sacks	Public Relations	Financial Services	Fruits	Postage & Equip
Cobalt	Tanks & Pumps	Entrenched Enterprise Apps	Electrical Services	3PL	Relocation Services	Uniforms	Flexible Packaging	Commercial Print	BPO	Vegetables	Consumer Financing
Natural Gas	Motors	Other Software	Utility Management	Courier Services	Outplacement Services	Medical Supplies	Plastic Containers	Promotional Products	Translation Services	Alcoholic Beverage	Sundries
Oil	General MHE	Network Infrastructure	Office Furniture	Freight Brokerage	Training	Pneumatics & Hydraulic Parts	Protective Packaging	Sponsorships	Transcription Services	Non-Alcoholic Beverages	Financial Research





ABOUT THE AUTHOR

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Conrad is an experienced sourcing professional specializing in Private Equity. He has 10 years of experience delivering procurement value in pre-purchase or post-close diagnostics, carveouts, and mergers/integrations. He has advised many sponsors including Apollo, LCatterton, Centerbridge, Warburg Pincus, Platinum Equity, HIG Capital, and KPS. His strategic sourcing experience is concentrated in Industrial, Healthcare, Retail, and Apparel sectors.

Prior to ISG, Conrad worked with the Operating Team at Accel-KKR and started his career developing vaccines at Merck & Co. He lives in Atlanta with his wife and daughter.

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Insight Sourcing Group is the premier professional services firm in North America exclusively focused on strategic sourcing, cost optimization, and procurement operational transformation.

Founded in 2002, Insight's capabilities are designed to accelerate impact through the expertise of its 250+ procurement experts, its market-leading Category Center-of-Excellence model, and practices specializing in Private Equity, Supplier Diversity, Energy Management, and Sustainability.

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