



## PRICING IN PROCUREMENT

SIBUR has been applying formula pricing for 10 years now. Andrey Sidorin, acting Procurement Director, Head of Chemicals Procurement at SIBUR, speaks about the benefits of this approach and about SIBUR's supplier management strategy.

A formula-based price is calculated using a formula that incorporates all possible market indicators, exchange quotes, deflators, FX rates, discounts, inflation indices, etc. This approach allows us to take into account key market trends when determining the price, and reduce the risk of unjustified price hikes by suppliers.

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**What are the main benefits of formula pricing for the buyer and the seller? Which advantages of such transactions are particularly relevant for SIBUR's partners?**

The main benefit of formula pricing is that neither we nor our suppliers play “cat and mouse” when determining the price. Where the cost of a product is largely driven by changes in a number of variables, such as the FX rate or the price of feedstock, the supplier tries to cover all its risks when using a fixed-price contract. As a result, the supplier sets a higher price “just in case” to hedge its risks for the term of the contract, for example, for six months. This is not the case with formula pricing, and we are guided by clear price drivers that each party is happy with.

The second benefit, which follows from the first, is that in the case of formula pricing we can sign long-term contracts, for example, for five years. The long-term partnership drives the supplier's confidence in the future, which has a positive effect on the price for our company. The supplier, in turn, can clearly plan their resources and capacity utilisation, and build similar long-term relationships with sub-suppliers.

**Not all contracts are signed on the basis of formula pricing. In which cases is this pricing approach not possible and why?**

This approach is not possible, or rather difficult, when there is no transparent market price driver for the product we purchase that would satisfy both parties. But even in these cases, we find a solution. For example, there is no market quote for wood to determine the price of wooden pallets, but we have linked the price formula to the price of a wood billet that our pallet supplier purchases as raw material.

## **What conditions should be in place to encourage a wider adoption of formula pricing within the company?**

The key condition, apart from the availability of a transparent price driver, is suppliers' willingness to enter into contracts based on formula pricing. Sometimes our partners do not agree to this approach because they do not understand how to handle this formula and how this pricing will work in the longer term.

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## **THE IMPACT OF THE CRISIS HAS BEEN POSITIVE FOR PROCUREMENT**

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### **The situation with scrap metal sales at SIBUR enterprises is very characteristic of this. What makes this deal special, and what is the role of weekly Russian scrap metal price updates?**

This is the first time we sold scrap metal this way. The novelty is that we carried out a consolidated procedure, having put the entire volume of scrap metal on the market. From the outset, we made it clear in the terms and conditions that we expected the formula pricing method to be used. The contract was awarded to the bidder with the most attractive price, determined according to the following principle: we review the price on a weekly basis using a formula based on quotes provided by the Metal Expert publication and the London Metal Exchange.

### **How is formula pricing affected by the economic crisis, the period of low prices, and pandemic-related restrictions? How has SIBUR's approach to contracts and clients changed in the new environment?**

In general, the impact of the crisis has been positive for procurement. Many price quotes went down due to the pandemic, so purchase prices have started to fall. On top of that, we held additional negotiations with suppliers. We came from the position that many companies had curtailed production – and consequently purchases – while we were ready to maintain our volumes if suppliers offered better prices. These negotiations have brought us incremental budget savings of up to 15%. Long-term contracts based on formula pricing are a guarantee of stability and confidence in the future for us and our partners.