

# Informita News

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## Procurement Taxonomies

### How to get it right and keep it right

It is nothing new to procurement professionals that good data is the basis for good cost management across a portfolio of different spend categories. But many companies have never quite cracked the problem. Those who have made serious attempts to solve the problem have found exercises to properly categorise spend and then maintain the quality of that categorisation to be extremely difficult and time consuming. Now a Dutch start-up, Mithra-AI has brought a new approach to the issue: human-led AI. There are two basic problems with spend taxonomies. The first is even having a simple understanding of what a supplier actually does. For example, is it a cleaning company or does it do something else? The second is having a meaningful purchase taxonomy that groups suppliers into subcategories of how spend agreements can be constructed. So knowing the supplier provides cleaning services is probably not enough. There will be a big difference between a company that does office cleaning or another that cleans the shop floor in a food plant or another that specialises in deep cleaning of industrial machinery. Mithra-AI's approach is first to collect several sources of data about supplier spend. That will include internally sourced data such as purchase order line items, spend values and any taxonomy that may already exist. But it could also include externally sourced data such as credit agency information, quality registrations, UNSD classifications and so on. They create an algorithm that matches the various data elements together that will enrich the data. That will get you 80-90% of the way. There will still be a need to review the algorithm to ensure there are no obvious anomalies. Hence they call the process human-led AI and not AI. This will then allow a suggested procurement taxonomy to be proposed based on all that data, what logical classifications might look like and what the specific client's business priorities might be. An example would be classifications for bottleneck spend items where the value of spend might not be that large, but the impact of supply shortage is very high. They then hone that algorithm and run it against all new suppliers so that the quality of the procurement taxonomy can be maintained at a high level into the future. They can highlight where the taxonomy needs to be amended to reflect changes in the spend profile or technology. It means new acquisitions can be quickly absorbed into the regime. The initial analysis can be completed in weeks. It means that procurement can focus on delivering cost savings and not endless data mining that is often too high level or incomplete.



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## Inflation and Basel III

A perfect storm?

It has now been in the news for many months that inflation is spiking in many countries across the world due to the confluence of increased fuel prices and supply chain disruption that started back in March 2020 due to the Covid-19 pandemic. Even the most optimistic observers do not expect inflation to recede before the end of 2022. This means that corporate costs are going up fast and this is impacting liquidity as margins get squeezed. In addition, we are seeing interest rate rises feed through in most large economies. So the era of almost free corporate debt is well and truly over. In parallel to these events, the Basel III banking regulations continue to be implemented by banks across the world. One major effect of these changes is that banks are forced to hold more in reserves. This reduces their capacity to loan money to their clients. For treasurers, all this is expected to cause a perfect storm of reduced liquidity due to inflation and higher interest rates and an additional squeeze on liquidity forced by banks reducing the size of their loan books. And the lower your corporate debt rating, the more likely that your company will be caught in this squeeze. Also, the true cash flow effects of the pandemic are yet to unwind as various countries' efforts to support businesses come to an end. This is expected to cause one of the highest levels of bankruptcies that we have seen for many years. The good news is that there is still time to act. It looks like 2022 will be a year when cash was king and it will be vitally important to have buffers of cash to navigate through the choppy waters that we will see over the coming year. Even the cash-rich might get somewhat nervous as events unfold. We would strongly recommend that you fix the roof before the storm comes.

## Unearned Discounts

Get your money back

Giving settlement discounts can be an effective way of getting early payment, although compared to other financing methods it is very expensive. In some industries in the DACH markets (Germany, Austria and Switzerland) settlement discount or skonto is a market norm and is fully expected by customers who use these values to bolster their profit numbers. But there is also significant abuse of the practice by many large companies, who use the fear of losing their business to impose an unfair cost on their suppliers. But you can get your money back. Firstly, your collectors should demand immediate repayment of these unearned discounts. This can be difficult at first, but the key is to impose a new discipline on the customer. Another technique is to claw back unearned discounts through rebate agreements. If you don't ask for your money, it will never return.





## ESG

Green washing by another name?

There is no doubt that the emergence of ESG is making almost all large companies across the world think hard about their impact on the environment and society and the quality of corporate governance. Even if some of these companies do the right thing because they feel coerced, in the long run, it is likely that ESG will transform many companies for the better. But there is some evidence that some other companies are giving the appearance of doing the right thing when in fact they are not. An example was a paper company that claimed to be using 100% recycled paper when they used no recycled paper at all. Apart from CFOs and treasurers having to take care of ESG, it is also key that procurement departments are aware of the footprint of their suppliers. Otherwise, there may be trouble ahead.



## Estonia: Happy and Thriving

As one of the “Baltic Tigers”, Estonia is a member of the EU and the Eurozone. It is one of the world’s most digitally advanced economies and is known for progressive social policies including having the longest paid maternity leave in the world. But this wasn’t always the case. After the restoration of independence in 1991, the country introduced radical economic reforms including mass privatisation of industry and currency reform. The reforms proved to be extremely successful and set the country on course for a spectacular level of economic development. Even after the pain of the pandemic, Estonia’s debt to GDP ratio is less than 20%. Estonia has proven to be very friendly to investors and this has attracted large amounts of foreign direct investment to support technology, engineering and the auto industry as well as many more subsectors in a very well diversified economy. It also happens to be a very beautiful and historic place focused on the capital Tallinn. Estonia ranks as one of the best places in the world to live as well as being economically vibrant. So what’s not to enjoy?

## SWIFT

### Why it’s important

The Society for Worldwide Interbank Financial Telecommunication was formed in 1973 and has become the almost universal standard used in “payment orders” between banks. We most usually see the evidence of SWIFT in the use of BIC codes when placing a bank transfer. This has transformed the international payments landscape and now means that for corporates without SWIFT it is near impossible to make any international payments at all. So what happens when you don’t have access to SWIFT. This is what happened to Iran in 2012. Since then Iranian banks have struggled to make international transactions. Even though they were readmitted to SWIFT in 2016, subsequent US financial sanctions have meant that the vast majority of the world’s banks avoid all dealings with Iranian institutions. Russia is now being cut out of SWIFT due to the invasion of Ukraine. This has implications not just for Russian oil, gas and metals, but also for all the goods that Russia imports. Paying attention to geopolitical events that might have a directly impact the supply chain is time well spent.

# AR Forecasting

## Key steps

Getting the first few weeks of an AR cash flow forecast is a tricky job if you really need to achieve a high level of accuracy. And there is much more to it than having the right algorithm, although that is important. On a recent assignment, we went through 4 key stages to get the weekly forecast right. The first was to look at historic data to understand what would be the best forecast algorithm. We tested 14 different algorithms before deciding on the best one. Next, we had to calculate how many invoices that do not currently exist would be paid in the coming weeks and to assess how stable the results were likely to be. We then assessed the viability of applying a forecast error correction algorithm. In this case, this had a very positive effect on 2 business divisions, but not on 2 others. It turns out that cash postings in these 2 divisions could happen up to 2 days late and a large proportion of postings happened on a Friday. This meant that the forecast algorithm was forecasting certain invoices to be paid that had already been paid. We were unable to change payment and posting practices in the short term, but we were to change the timing of the forecast calculation so that more invoices would be posted improving the algorithm performance. Even after this, the results needed to be monitored for outliers. And finally, remember that circumstances will change, so the process should be reviewed at least every year.



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Website: [www.informita.com](http://www.informita.com)

Twitter/Facebook/LinkedIn: @informita

Email: [brian.shanahan@informita.com](mailto:brian.shanahan@informita.com)

Phone: +351-911556662