From the pages of Supply Chain Management Review

Ten Proven Ways to Cut Your Spend

By Patricia E. Moody -- 12/1/2005

When CEOs want to generate cash—for new products, new plants, workforce compensation, or just their favorite boondoggles—they still look to procurement to come up with the dough. For those companies that have sophisticated buying processes and bare-boned outsourcing relationships in place, finding the necessary money may not be all that difficult.

But what about those other companies—and they are likely in the majority—that still struggle mightily with cost reductions? They may have made a hasty outsourcing decision that locks them into unnecessarily high costs. Or they may be stuck buying basic commodities through many different points across various divisions and plants. In fact, they probably don't even know exactly how much they spend. So does it make sense for even these traditional operations to attempt double-digit savings?

The quick answer is: Yes, of course it does! Because there's gold in the most unexpected and unexplored places. And it's not all in the well-worn area of lean manufacturing.

To find out where purchasing professionals should be panning for that gold, we went directly to the source. We put out a call to leading supply management executives and consultants. We wanted them to contribute their very best recipes for 10-percent savings—or better—and we were absolutely overwhelmed by the avalanche of suggestions. It took three weeks to chew through the e-mails, cut out the spammers and the duplicates, and condense all the valued input into 100 pages of juicy ideas for a book I wrote recently called The Big Squeeze. This book was intended to help purchasing pros cut their spend by at least 10 percent right away.

Many of the suggestions we received focused on "soft" expenses. These included MRO (maintenance, repair, and operating) expenses as well as other generally neglected categories for office supplies and equipment, travel, and especially communications services. We also heard about continuing opportunities to reduce costs in production operations. But even if your company has outsourced all production to Timbuktu, your "white collar" operations—such as final assembly of customer orders in distribution centers—are prime candidates for the kinds of kaizen continuous improvements that adherents of lean and Japanese production methods enjoy.

The supply management leaders we contacted also cited e-auctions and e-sourcing as great paths to increased savings—provided the users picked the right commodities for the Web. For example, Sam Santosuosso, director of supply chain management at Axcelis Technologies in Beverly, Mass., saved 17 percent on cleanroom supplies on a $350,000 spend by effectively leveraging Web-based resources. "That was well above our 10-percent target," Santosuosso reports.

Other responses ranged from both innovative and traditional approaches to supplier relationships, to a brilliant technology-intensive application of risk management software used by United Technologies Corporation to manage its globally dispersed supply network.

Reviewing the ideas received from the experts, it's clear that many successful initiatives go after the easy savings and then build momentum for the bigger things. In fact, this seems to be a pattern for sure savings. For instance, a template for supply management success developed by the late Gene Richter, former chief procurement officer at IBM, hinged on spend consolidation and expert buying. And Dave Nelson, Honda's former purchasing chief, proved again and again at Deere and Co. and Delphi that there is gold in low-hanging MRO fruit.

Nelson understands that MRO and other soft expense categories present huge opportunities for consolidation and negotiated savings. Moreover, these savings are more easily obtained than—and indeed buy time for—the more challenging direct materials expenditures. (Direct materials are those items that are incorporated directly into the final product.)

The following example shows the potential savings often hidden in MRO. During a typical 12-month period, John Deere's 15 North American plants had been purchasing more than 424 different SKU's of gloves totaling $1.4 million in spend. In reality, the true requirement was somewhere between 20 and 25 SKU's. But it took a student intern working at Deere to dig into the data and come up with the gold.

The intern learned from one of Deere's suppliers that a welding glove it sold to a competitor for $1.50 was cleaned after use for welding, then sent out to the line for other applications. Deere, on the other hand, was paying a minimum of $7.50 for an all-leather, one-time-use glove! Presented with this information, the buyers quickly recognized that the custom-solution glove at $7.50 per use was more than what production actually needed. By switching to a more sensible choice—a general purpose, reusable glove similar to the welding glove—planners realized immediate savings of 35 percent out of the total $1.4 million glove spend.

Three lessons emerged from the Deere glove story:
Take a hard look at variety. Deere had been ordering more than 400 different glove types, when in reality it only needed about 25.
Pay attention to prices. When Deere realized that they were paying five times what their competitor paid for gloves, they knew that they had work to do.
Examine how materials are used. Upon investigating the situation, Deere realized that the gloves did not need to be a single-use item.

Ten Easy Pieces

So let's see if we can take all the great input we received and simplify the journey to big cost savings and competitive advantage. We've narrowed the exercise down to 10 ways to cut your spend 10 percent right now—not in five years after that gigantic ERP system lumbers toward its projected ROI, not two years after the current contracts expire. But right now!

1. Consolidate the spend.

The only way to access the power of the leveraged spend in the marketplace is by consolidating all the disparate requirements into the fattest negotiating tool possible. Sounds simple enough, but it can be unbelievably challenging in organizations that cannot consolidate buying responsibilities under a single “uber-buyer.” Gene Richter at IBM skillfully worked around this challenge. In fact, he did not want to have every IBM buyer reporting in to his office. Instead, Richter instituted a commodity council and incentive systems that controlled the buying processes. The end result was the same as having a centralized buying organization. But Richter’s approach avoided many of the inevitable turf battles that accompany a shift from decentralized to centralized buying.

Implementing the right data systems is another way of navigating around the centralized/decentralized dilemma. Where job functions themselves cannot be consolidated, data is a good proxy. When buyers have numbers on their side, their case for promised cost savings from leveraging the buy holds sway over turf politics.

2. Don’t overlook the soft spend categories.
As we discussed in our introduction above, the quickest route to savings is to start with MRO and other soft expenses such as travel, legal, public relations, and telecom. Payback is quicker with these soft categories—sometimes immediate—and investment is modest. Consider this example from the telecom area, sent to us by Mike Frederickson, EVP of KineticWorks:

“Do you know how much you are spending on local, long distance, pagers, wireless, and other network-related expenses? Most small- to medium-sized organizations do not manage the full life cycle of telecom expenses and services because they do not have the tools, resources, and expertise to keep up with the ever-changing telecom industry. Without addressing each phase of the life cycle each and every month, companies can be overspending by as much as 30 percent. By outsourcing your telecom expense management, you can save up to 30 percent your first year.”

3. Identify true costs of outsourcing.
Since the outsourcIdentify true costs of outsourcinging movement took hold over 10 years ago, the scope of outsourcing relationships in the supply chain space has increased dramatically. So has the potential cost of these relationships. Consequently today, it’s more important than ever to identify the real cost of any outsourcing arrangement. Over and above the basic services to be provided, buyers need to identify the cost of any ancillary or extra services provided, such as handling and tracking, kitting, packaging, customer service, and so on. Several of the experts we heard from suggested investigating (or re-investigating) the potential for outsourcing in such diverse areas as IT, indirect purchasing management, security, payroll, and janitorial services. Some even suggested outsourcing the purchasing function itself!

4. Get a grip on packaging, transportation, and logistics costs.
A good rule to live by is, “Don’t pay to ship air.” Toward this end, Harley-Davidson and UPS incorporate planning for packaging specifications and configurations very early in product design stages. In addition, the packaging suppliers are involved early on to give them a glimpse at quality and shipping requirements. (And did you know that professional engineering package design help is available at no cost. These valuable resources are listed in The Big Squeeze.)

Here are a couple of packaging-related initiatives we received from Raul Fernandez, VP of Technology and Innovation at Chiquita Fresh North

America:
"We are in the food business, and we have located our R&D group that creates our corrugated and plastic packaging ideas right next to our growing areas. It allows us to go from concept to execution very quickly. Our 'in-market' teams can quickly transfer an identified unmet customer need to the team that can find and execute the right solution.
'Fail early, fail cheap' allows you to quickly test and evaluate concepts, as much and as quickly as possible to sort the brainstorms with potential from the 'no-go's'. For instance, we make our own boxes. We buy our own roll stock. By designing and making boxes ourselves, we reduced the number of different paper types from 27 to six! That allowed us huge savings."
Another enormous cost contributor to transportation/logistics is, of course, fuel. Traditional measures to reduce fuel costs, such as good fleet maintenance and reduced idling time certainly help. But our experts offered additional recommendations, such as smarter fuel buys and computer-generated network designs for inbound freight.

5. Pay attention to product design.
Ninety percent of product costs, including shipping and packaging, are set during a product's early design phase. And one of the biggest drivers of high costs is complexity that is introduced during the product design stage. Take the example of the batteries that Motorola had been specifying for its cellular phones. As the engineers sped though new product introductions, they kept introducing new and improved batteries, which may have had some incremental value from a technical standpoint but added unnecessary complexity to the product line. Had the designers been measured on the concept known as "creative simplicity," they might have worked hard to reuse battery types from one new product introduction to the next.

By contrast, early design work to minimize component complexity on Honda's 1998 Accord reduced the overall product costs by over 25 percent. A proven way to combat unnecessary complexity in
product design is to tackle the problem on a commodity-by-commodity basis. IBM's procurement operations under
Gene Richter were masters at this. Richter and his group insisted on written commodity plans that laid out basic data on each commodity. This included, at a minimum, market trends, total spend, pricing, technology issues, and forecast requirements.

6. Calculate the true product costs.
There are several methods of calculating true product costs. These include the traditional cost accounting approach that covers material, labor, and some distribution of overhead costs. There's also the "target cost" approach followed by such companies as Honda and the "cost standards" (or "should cost") method adopted by Toyota. Regardless of which approach is used, the experts emphasize the importance of including all costs—shipping, handling, packaging quality, and so forth—in regular looks at product costs. Toward this end, Honda veteran Chad Moody (now at Ford) uses cost breakdown sheets with suppliers that enable buyers and designers to gather all of the critical cost information very early in the design/production cycle.

7. Establish a comprehensive supplier management program.
Training suppliers to perform to desired delivery and quality levels is critical to supplier management. A big part of this effort needs to focus on helping them implement kaizen and lean manufacturing methods. A comprehensive

supplier management program also requires a robust performance-measurement effort. When commodity managers are able to closely track supplier performance, they can more quickly and effectively identify existing or potential troubles spots for rapid follow-up. This process can be facilitated by supplier development and supplier-managed inventory programs. Supplier management starts with data and regular direct feedback around key success indicators. How that gets translated into effective supplier management programs depends on resources and the will of the purchasing leaders.

8. Verify, track, and control (VTC).
Cost savings that are not verified by finance tend to evaporate before the next quarter. Supply managers who deliver a savings should follow up to ensure that the gains don't drift over into another area of spend, where they could melt under the noonday sun. Take the example of buyers reining in and consolidating travel expenses for big savings. To realize the full ongoing benefit of these gains, they must be subtracted from upcoming budgets and monitored for continued performance against budgeted target.

9. Accelerate quote-to-cash and review payment terms.
Dell's build-to-order and cash-realization models are great examples of quick cash recovery. Mike Gray, Dell Evangelist and Big Squeeze blog contributor, recommends looking at the cash-conversion cycle within the context of its three main elements: inventory, receivables, and payables. By focusing on these areas, he says, companies can more readily identify opportunities for savings. "So you want to cut 10 percent out of your business right away?" he asks. "Extend payables by 10 days and see what happens, or reduce your inventory—or do both. Not only will it save your enterprise cash today, it's the gift that keeps on giving!" Other opportunity areas lie in aging the receivables, increasing Web transactions, and reviewing payment terms for early payment discounts and other cash-saving opportunities.

10. Create suggestion systems for suppliers and internal employees.
For many companies seeking to identify areas of improvement and cost savings, the best place to start is their own employees and suppliers. In particular, suggestion systems are an inexpensive way to capture the brain power of the people closest to the action. At the same time, we caution anyone thinking about instituting a suggestion system to carry it through. That is, they need to first build a mechanism to track and reward good suggestions while filtering out the impractical ones.

Room at the Top

When the "big squeeze" is on them, purchasing professionals can turn to the 10 areas described above to relieve the pressure. But remember where you're starting from and try to set expectations accordingly. We've observed a wide spectrum of gradually increasing savings opportunities that are most often associated with an operation's maturity. Newcomers to the game, for example, can easily score 1—2 percent in annual savings just by paying attention to a few basics, including spend consolidation.

The next level up, intermediate, is where 80 percent of North American companies lie. They typically have systems and some data that allow them to attack opportunities by commodity—over and above gains already made in spend consolidation. They may find it difficult to achieve double-digit savings year to year. But they have also discovered along the way that supply management is a vehicle for creating competitive advantage and growing profits as well as cutting costs So in this sense, they are better positioned

than the newcomers to move quickely in the 10 areas noted above.
The highest level houses the experts: the supply management leaders like Hewlett-Packard, Dell, and IBM. These companies have innovative systems, superior supply management leadership, and well-integrated tools that put them ahead of the pack. The experts have already wrung unnecessary costs from their supply management operations. They now focus intently on how supply management can be put to competitive advantage as reflected in the key indicators like market share, revenues, and profitability.
Granted, the leaders in the expert category have built up a huge lead on their competition. The good news is that there are relatively few companies at this level—and plenty of room for your organization to move up.

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