

CASE STUDY: ACCELERATED PRODUCT COST REDUCTION

Executive Summary:

With bought – in product costs representing typically 40-80% of the total cost of sales, even modest % cost reductions can represent important direct improvements to the bottom line.

By applying a focused and prioritized methodology to addressing overall product cost, we have typically undertaken to reduce product cost by 10-15% and on occasion by as much as 40%.

The approach is typically multi-disciplinary in nature, highly quantitative and focused on strengthening the client's negotiating position in their market place.



Background:

As companies face increased competition and the eventual erosion of margins, a product cost reduction strategy is often required in order to preserve shareholder interest.

Historical buying patterns and expedited procurement during product introduction, often place companies at a disadvantage when negotiating life of program product costs. This leads to a cost structure that, while acceptable initially quickly becomes a hindrance to extracting value as the product matures.

By looking at the overall product cost components in the context of the overall purchasing patterns of the company a number of low hanging opportunities are often readily identified and strategies implemented.

Results:

Bought-in product cost typically includes three categories:

1. Custom
2. Special
3. Commodity

Cost reductions of up to 20-40% can be achieved on Custom and Specialty items while commodity items usually only yield 5-10% improvements

A rough cut cost reduction model is used to identify the order of magnitude savings required and helps focus efforts on areas with the most bang for the buck. ROI on such projects is typically 10 or 20:1.

Approach:

The approach to cost reduction includes a number of tools to help achieve focus, leverage and action.

Focus is brought by using the Pareto principle to identify those items with the highest contribution to the total cost. This is complemented by an opportunity matrix which helps address only those items which will yield the most value for the effort.

Leverage is achieved by identifying clear strategies for each initiative that will strengthen the client's negotiating position. This may be the identification of volume trends, commodity consolidation opportunities or simply systematic challenging of the status quo. In specific situations, creative RFQ and negotiation processes are undertaken to create value. Introduction of such concepts as Long Term Agreement (LTA's) and Vendor Auctions can be useful.

Action and momentum are maintained through tight project management, follow-up and reporting tools.