

Getting the Most Out of Cost Reduction

By Patrick J. Horgan, Partner, **Paladin Associates Inc**
www.PaladinAssociatesInc.com

A recent article in **Paladin Associates' CheckMate Newsletter** entitled, "**Cost Reduction is NOT a No-Brainer**", generated interest and requests for more information. It made the case that cost reduction programs should be carefully thought out so mistakes and inexperience don't cause harm. What follows are some common ways that cost reduction programs can be mismanaged, go wrong, and cause real headaches. It is NOT a complete list!

Companies with **inadequate spend information** really don't know what they are spending, who is spending, and who they are spending with. Without such fundamental intelligence chances are high that resources will be misdirected or wasted, and results will be sub optimized.

Many companies simply need to focus on **fundamentals**. It is surprising how many companies do not consolidate purchases or buying points, do not require system or product specifications, or do not require suppliers to compete on a regular basis. Many firms simply need to get back to basics.

A common oversight is **indirect spending**. Companies often focus exclusively on strategic direct materials and ignore indirect spending on telecom, facilities, transportation, office supplies, and so forth. Yet big savings are often available in these areas.

A frequent obstacle to efficient cost savings is **lack of buy-in** by the organization. It is an unfortunate fact that not everyone in a company is cost-sensitive, or sees cost reductions as being in their interest. In fact, many employees, and even managers, are "empire builders", actually more interested in maintaining or growing budgets, organizations, and perceived power. They may talk a good game, but really are not committed to cost-reduction. They may even fear cost reduction. Internal politics and power struggles are very often the chief obstacle to more efficient processes and procurement.

Frequently, the cost-reduction "team" lacks the specific **functional expertise** to effectively cost-reduce certain functions. Finance or Procurement personnel are generally not the best people to effectively cost reduce Marketing & Sales, Human Relations, Customer Service, Telecom, IT, and many other functions requiring specific product, market, contract, technical or professional functional expertise and judgment. This requires balancing both functional skills and cost awareness. Establishing cross-functional teams with both functional and procurement expertise is one solution

“Right-sizing” or down-sizing is an area of great risk. Downsizing can improve a company’s health dramatically, or destroy morale and precipitate a “death spiral”. Many of the issues are not intuitive. This topic needs a book in itself, and requires experienced hands to get positive results.

Frankly, **overly cozy vendor relationships** can get in the way of effective cost-reduction. Suppliers’ sales people work to establish personal relationships and “differentiate” their products for reasons other than price. They are often successful in minimizing competition as a result. But this usually costs the buyer money!! Some favorite sacred cows are sales commissions, legal fees, HR benefits, ad agencies, and printing companies.

On the other hand, **not understanding a supplier’s full capabilities** can result in overlooked opportunities for savings. A supplier might well have the resources to help reduce costs through process or product changes or simple suggestions, or other approaches not defined in a formal spec or RFP.

An ironic mistake that companies can make in tough times like these is **locking into a new “low” contract price**, only to find that prices actually drop below that level over time...resulting in overpayment during the contract period. Don’t mortgage the future simply to insure short-term savings.

Many companies have a **do-it-ourselves mentality**. They do not believe they need help, or they don’t want to pay for consulting help. But nonetheless they are just not getting the total job done. “Not-invented-here” and the “we-already-thought-of-that” syndromes are common themes in many companies. The “fear factor” also plays a role... many employees are concerned about getting credit for cost-savings ideas, or of being blamed for ideas someone else may find. In our increasingly “blaming” society, they are not always being unreasonable either. Many companies have inadvertently set up **win-lose scenarios** on cost reduction that block the free flow of ideas and participation, and inhibit the use of consulting experts whose savings ideas might expose waste. But all companies have waste, and wise companies want to find it and remove it ASAP. Setting up a win-win environment is key, and getting outside help is smart.

A very common problem for procurement organizations is **lack of appropriate resources**. Most companies, even those with large procurement staffs, lack all the skills, the manpower, the funding, and the time to turn over all the rocks required to get the total job done. An ROI analysis would frequently justify more resources. Or, temporary use of consulting resources may be appropriate.

Another common phenomenon is **excessive focus on identification** of cost reduction opportunities and process development, but inadequate attention on execution and results. Many companies have long lists of opportunities, but short lists of what have actually been accomplished or resulted in tangible savings. In a related vein, savings can erode over time if companies don’t monitor results, update specs, record engineering changes, housekeep records, etc. **Implementation, follow-through, and measurement are essential in driving for results.**

Effective cost reduction is not just about common sense. Like so many other things in life, it requires experience to do it right and avoid costly pitfalls. In tough times like these, with so many “new” managers being pushed into cost-reduction exercises, finding experienced hands to guide the process is critical. Professional consulting help should be considered, particularly with a company whose fees are based on results.

Pat Horgan

Partner

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