ONLINE EXCLUSIVE:
Cut Your Spend

By Patricia E. Moody

Manufacturing companies spend 20 percent to 30 percent more for their purchased materials than they should. If this horrifying statistic isn't enough to direct more focus to strategic sourcing, and in particular the analytics and disciplines that shape spend management, then I'm guessing your company has already reached the expert level on the Shingo scale.

"If it's true that companies could easily cut their spend 20 percent to 30 percent, it's equally true that they don't know the true cost of at least that much of their spend," Patricia E. Moody said.

If you work on the manufacturing side, why should whatever is happening in strategic sourcing matter? When ISM CEO Paul Novak said, "Purchasing will own manufacturing," he was describing a more integrated enterprise where visibility of the spend was easy to attain, clear, actionable and not an exercise confined to "those guys over in purchasing."

Let's look at a few gems from Quentin Samelson, strategic sourcing guru and Motorola-veteran, that illustrate the power of spend management. Samelson, now at Nokia Siemens, has seen it all, and he knows the telltale signs that signal out-of-control costs. Take shipping, for instance, where Samelson recommends that we take a walk. Conduct an inspection tour of the stockroom, receiving dock and other areas looking for stacks of FedEx (or other air freight) labels. If many are found in the stockroom, air freight is probably being used inappropriately or too frequently. This is an easy way to cut operating costs quickly.

In a profitable integrated enterprise, everything — purchasing, production control, logistics and operations — is connected. “I observed this at two different jobs ... unopened boxes, still with their air freight labels, sitting in the raw materials warehouse.,” Samelson said. “Once in a while, it could happen because of a last-minute schedule changes (what was urgent yesterday is suddenly not urgent today), but if you see very many instances like this, it may be due to either a buyer or a supplier mistakenly applying airfreight as the standard shipping method, because one-shipment last year (of that part number, or from that supplier) was urgent and had to be sent via air freight. All it takes is for the buyer to tell a distributor ‘Make sure you ship it air freight’ one time, and the customer service person at the supplier may code it as the default shipping method.”

Everybody appreciates the joy of tracking a shipment all the way from China, through Shenzhen to Shanghai and on to Los Angeles. But Samelson said he believes this is a quiet and costly addiction. “Buyer/planners sometimes get hooked on the fact that air freight is easy to track,” he said. “It gets tiresome when people ask, 'Where's that shipment?' and you can't answer. So they may tend toward air freight just to get the easy tracking. However, it's really not very hard to get tracking service with small parcel shipment these days. So you don't have to go all the way to air freight to be able to track a shipment.”

It gets worse, because we have unintentionally built bad practices into our reward systems. How could that be? Samelson calls it a conflict of metrics. “The buyer may be measured only on part cost, which may push him or her to a somewhat less reliable supplier,” he said. “The cost of freight often ends up on the manufacturing line, or at least is not part of the buyer’s scorecard. It can get even worse if the buyer is measured on his or her suppliers' on-time performance. Then the buyer is incented to bring in the cheapest parts, on schedule ... but doesn't get penalized if freight costs are too high.”

And I thought all these lovely performance measurement incentive systems were just that — designed to reward great performance.

Here’s a major contributor to our current problem of unplugged, rusted out, patchwork ERP systems. Samelson warns about unrealistic manufacturing schedules in the MRP system. “It happens when you have multiple people trying to use the same (limited) resources,” he said. “They'll drive materials in so that materials shortages can't stop production, but they're all scheduling a constrained resource so the parts just sit. This can also be caused by out-of-control sales commitments or customer service people jockeying for position for their customers.”

Does that actually happen in the real world? Who can answer that loaded question — because without great spend management and analytics, not every action has a direct, trackable consequence?

Another clue for excess spend hunters: dust. “Look for dusty boxes, period, in the stockroom,” he said. “If materials are sitting around long enough to gather dust, there's something wrong with the way they are being brought in. Even in those cases where it made economic sense to buy a large lot of parts, dusty boxes indicate lack of activity. If you see dusty boxes on the main thoroughfare of your stockroom, you have slow-moving material interfering with the efficient operation of the stockroom. Consolidate { the boxes} and move them someplace away from the action or get rid of them.” Where stockrooms have been replaced by staging areas or line side storage, the same dust dictum applies.

One last recommendation caused me to stop and think about part numbering schemes, especially random versus derived part numbers at the heart of the part master file. “Working at smaller operations, I observed that it was perfectly understandable to start out storing parts in part-number sequence,” Samelson said. “But if the operation grows very much, that becomes completely inappropriate. It seems like this is very much like the ‘how to boil a frog’ story. People just don't notice that things are getting out of control because they're not using random storage. At one company, people would force additional containers of a part number into position when there really wasn't any room left. Other

containers would get shoved to the shelf behind. Parts would ‘wander’ up and down the length of the shelving, and of course they could never be found when they were needed. So we'd buy more — and then have to write off the "lost" part when they were found again.”

It’s really easy to get seduced by a particular idea or tool, whether it is JIT or lean or SPC or Lean Six Sigma, and forget that they are all just tools, they are not the goal. The goal is profits, or lower costs, or improved productivity — and a good supply chain or materials manager will evaluate how various tools can be applied to achieve the goal.

So much for the obvious, but what about how the data can tell us about spend patterns? If it’s true that companies could easily cut their spend 20 percent to 30 percent, it’s equally true that they don’t know the true cost of at least that much of their spend. I learned from watching Honda and its suppliers work over their spend, and it’s true that most companies don’t have IT in place to tell them accurately and in sufficient detail what their products and parts really cost to make — not the negotiated supplier price, but the actual calculated cost. Some companies have developed great history capturing what products have cost at various stages of the life cycle, and a few really adept companies have on-line resources that allow engineers and buyers to derive target or should costs, but most companies don’t have access to actual costs until well after products have shipped. It shouldn’t be that way, and with good category and spend management in place, actual costs get clearer.

One last caution about the power of spend management. When your company works hard at spend reduction by either working with suppliers or changing specifications, even just shopping around, good spend management practice dictates that the savings from your hard work shouldn’t get buried in next year’s new phone system, or some unrelated, untrackable boondoggle. This is tough. You want to preserve the savings and move them to the bottom line. That requires documentation. If you save it, don’t spend it.

For other spend management tips and ideas, check out *The Big Squeeze, 10 Ways to Cut 10% of Your Company's Expenses Right Now!* Patricia E. Moody, 2011.

Named by Fortune *magazine a "Pioneering Woman in Manufacturing," Patricia E. Moody, tricia@patriciaemoody.com, is a business visionary, author of 14 business books and hundreds of features. A manufacturing and supply management consultant for more than 30 years, her client list includes Fortune 100 companies as well as startups. She is the publisher of* Blue Heron Journal*, where she created the* Made In The Americas (sm) *and the* Education for Innovation (sm) Series*. Her next book about the future of manufacturing is called* The Third Industrial Revolution*.*