ARTICLES

There’s More to Cost than Cutting

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Its role as a supply chain driver has changed, joining factors like aligning to business imperatives, meeting customers’ needs and enhancing supplier relationships as ways to spur growth.

By Sue Doerfler

Key Takeaways

- Cost is still a supply chain driver, but other factors, like value and optimization, have gained momentum.
- An organization’s view of cost will continue to evolve and change.
- Cost-centric supply chains are aligned with business needs.

Supply management organizations are undergoing a transformation — not only the digital kind, but also in how they view cost.

Once the primary, if not sole, driver for supply chains, cost is being viewed differently. Disruptions of all sorts — including geopolitical tension, climate change, the coronavirus pandemic and freight market challenges — are causing companies to reevaluate their priorities and focus.

While the best cost is still important, supply chain factors are multidimensional and just as significant in negotiations. “Supply chain teams still have to manage costs, there’s no doubt about it,” says Tim McDonnell, supply chain specialist with the Purdue University Manufacturing Extension Partnership in Carmel, Indiana. “But now their decisions and how they manage have to also be about enabling revenue and improving customer satisfaction. It’s not just cost anymore.”

ailability of materials, what customers want, aligning with the business, generating growth and capturing the best value.

At any given time, one element might be more important than another, depending on the business objective and customer. "Supply chain teams have to be nimble enough to adapt," McDonnell says. "If your focus is on growth and revenue, you may not want to focus all your efforts on cost reduction actions. You may want to focus on having a responsive supply base that can react better, reduce lead times and can be more flexible to what may be changing in your value chain."

As supply chains evolve and organizations adapt and become nimbler, their view and approach to cost will also continue to evolve and change.

How Did We Get Here?

COVID-19 made a big impact on how supply management organizations consider cost. Supply availability became the most important consideration for a number of years.

"Very early in the pandemic, at a prior company, one of the things my team and I did was pivot, prioritizing supply continuity and deprioritizing cost," McDonnell says. "Due to the shortages, continuity of supply became most important because losing a customer (due to no product availability) is a large cost to an organization. That's where alignment with the business is very important."

For some organizations, movement from cost started before the pandemic. For others, factors like digitalization play a role in determining priorities.

"Leaders today feel like they are in a technology blizzard of change — there are so many things happening so quickly that it's hard to know where to point your focus," says Doug Gish, who serves as Deloitte's global operate leader.

Regulations are another factor. Leaders also confronting an accelerating regulatory environment that requires ever greater data collection, insights and reporting. Additionally, their risk envelope has changed radically in recent years.

According to Deloitte researchers, cost optimization — in which companies emphasize growth investments as well as savings — is a more effective management approach than cost reduction. "This is an opportunity to not think about the term 'cost out' as many independent events that add up to a certain figure," Deloitte global operate leader Doug Gish says. (Image credit: RerF/Getty Images Plus)

Inflationary Pressures

Elevated post-pandemic inflation and the interest-rate responses by the U.S. Federal Reserve have also impacted how cost is viewed. For some organizations, this is renewing their focus on cost, but not as the sole driver. Instead, it's focusing on cost from an affordability standpoint.

“All of us have been affected by the inflationary pressures, and for small and medium-sized companies, it’s been more impactful,” McDonnell says. Unlike multinationals and large Tier-1 suppliers, smaller companies usually don’t have the resources and leverage to manage inflationary cost impacts. They’ve had to look at cost through a different lens, he says. Strategies include:

- Indexing, where material cost is tied to an index and can be adjusted up or down based on how the material cost is moving. “It doesn’t help reduce cost, but it gives cost certainty to the business,” McDonnell says. “Your business can manage more efficiently because you have cost structure visibility.”
- Value-engineering workshops, with suppliers invited to participate. “Collaborating with your suppliers helps you focus on the cost managing effort together and helps with relationship building,” he says.
- Strategic inventory practices, like (1) partnering with customers or suppliers to help manage inventory or (2) improving inventory management practices like segmenting inventory via an ABC-XYZ analysis.
- Improvement in supply chain visibility.
- Lessons learned from past experiences. Organizations should ask such questions as “What could we have done differently?” and “How will we change our approach next time?” These questions, McDonnell says, “act as a catalyst to start changing the design of your supply chain models.”

Cost Optimization

Talent shortages underlie the challenges facing organizations, Gish says. Yet, most are operating on a growth agenda.

“With growth at the top of many leaders’ strategic agendas — and with growth as an increasingly complex goal to achieve given margin pressures, economic uncertainty, and the increasing competitiveness of innovation — organizations need to avoid ‘death by a thousand cuts’ and adopt a strategic, more holistic approach to cost management instead,” states a Deloitte Insights article co-authored by Gish.

“Unlocking the Promise of Cost Optimization” further notes that companies need to look at investing in longer-term “growth opportunities such as innovation, enhanced capabilities, and expansion into new markets,” it states. “Welcome to a new era, one in which cost optimization — not cost reduction — is taking hold.”

The word “optimization” was chosen specifically, says Gish. “This is an opportunity to not think about the term ‘cost out’ as many independent events that add up to a certain figure,” he says. “It’s really about how to intelligently design a cost program that looks at areas for investment and where you potentially have efficiency opportunities and putting all that in balance. It’s breaking down the silos of how people have traditionally addressed cost-out programs.”

Growth, reinvestment and innovation are the new normal when it comes to cost, Gish says. While cost reductions will lead to short-term benefits, he says, they can lead to issues down the road.

“How many times have we seen organizations squeeze their suppliers, then squeeze them again and squeeze them again?” he says. “At some point, the organization will start to lose that quality edge with its suppliers and will get less responsiveness from them. The organization may become a less attractive customer for them.”

Then, when the market shifts and an organization wants to ramp up production or distribution, what happens? “You discover that those suppliers that were always by your side before, now tend to be a little bit more risk averse in how they want to engage the organization going forward,” he says.

Organizations need to balance cost with value. Cost improvement remains a valuable tool, Gish says, but supply managers need to be intelligent about how and where they use it. They must focus on how they are going to reinvest, what the trade-offs are, and how and where value can be created, he says.

“Some of it may be bottom line; some will be in innovation or building new capabilities,” Gish says. “But there has to be a mindset around how we utilize it for the organization.”

The ROI of cost management is limited if products aren't available when customers want them, which Bath & Body Works knows as well as any company. Its more than 2,300 locations around the globe reset store displays every four to six weeks. "(S)peed, agility and availability of our product is very critical," says Susanna Zhu, senior vice president, global sourcing and supply chain operations. (Image credit: Parradee Kietsirikul/Images Plus)

Aligning to the Business

The new definition of cost-centric supply chains could well be alignment with business objectives.

"By embracing cost optimization, companies can align their financial objectives with their long-term strategic goals, helping ensure that every dollar spent contributes to the overarching mission," the Deloitte Insights article states.

No matter the industry or sector, aligning to business imperatives makes sense, Gish says. While each industry or sector has distinct challenges, they have "shared imperatives to increase operational efficiency in a way that powers their longer-term success," the article states. "To that end, organizations in both sectors are laser-focused on objectives like collaborating with strategic partners, optimizing physical assets, streamlining supply chains, capitalizing on advanced automation … and more effectively managing their people."

The article cites a Deloitte survey in which nearly 100 percent of senior business executives agreed that striving for a stated objective is a better way of doing things, Gish says. Their consensus, he says: "(Companies) don't want to just rip cost out because they know that that leaves unintended consequences, making it difficult to recover. They want to make sure they're building for the future."

Meeting Customer Needs

At Bath & Body Works, building for the future means putting customers first. Cost is only one of many elements driving its supply chain.

"Having the speed, the agility and product availability during the right selling window —and at the quality that our customers expect — are often more important than just the unit cost," says Susanna Zhu, senior vice president, global sourcing and supply chain operations at the personal care and home fragrance company.

"As a specialty retailer, our products turn very fast in our stores, where inventory levels are based on customer demand," she says. Bath & Body Works, which has more than 1,870 company-operated U.S. and Canadian locations and nearly 500 international franchised locations, resets its store displays every four to six weeks.

"In the front of our stores are seasonal displays that are specifically designed to sell during a particular time window," Zhu says. "That's why speed, agility and availability of our product is very critical."

Consider Halloween products, for example. They have a selling window of several weeks, with the intent of selling all products by end of October. If a product doesn't sell through in that timeframe, it may be heavily discounted after the holiday. "So, for us, cost is only one element," says Zhu, a member of Institute for Supply Management®'s (ISM®) Board of Directors.

The company also has an array of core products across the key categories. "We always have core products; those are long-standing fragrances that our customers love and look for all year round," she says.

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"Supply management is about enabling profitable top line growth," Zhu says, "and the combination of delivering products at the right place at the right time, right quality and the right cost are all critical to the success of our function."

Gish notes that pieces of supply chains have operated independently for decades. "We need to bring together the idea of integrating all the components of the supply chain in a way that not only improves the efficiency but also drives a significantly higher value of that function as well. It's being cost-conscious and value-focused around supply chain," he says.

(Top image credit: MicroStockHub/iStock/Getty Images)

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