

Total Cost Management

The Hidden Profit Center

What Is Total Cost Management?

- A systematic approach to identify and manage the cost drivers associated with commercial transactions
- Identify the cost drivers and determine the value
- Eliminate non- value adding or unnecessary cost drivers
- Measure Critical To Quality (CTQ) aspects of the work
- ┘ Reward Performance

Why Focus On Cost Management?

- What do you control?
- Finished product pricing is determined by the market
 - Applies to Producer
 - Applies to Service Provider
- You impact COGS
- Every \$ saved is a \$ increase in margin

COST MANAGEMENT

- COST VERSUS PRICE ANALYSIS
- IDENTIFYING COST DRIVERS
- TARGETING THE OPPORTUNITIES
- SCAN PROCESS

COST VERSUS PRICE ANALYSIS

- WHAT IS THE DIFFERENCE?
- WHAT TOOLS ARE AVAILABLE?
- BENEFITS OF COST ANALYSIS
 - BOTH SIDES WORKING FROM THE SAME INFORMATION
 - FOCUS ON THE REAL ISSUES
 - IDENTIFY WHAT DRIVES COST AND WHY
 - GIVES YOU THE BASIS FOR DEVELOPING A COST MODEL

IDENTIFYING COST DRIVERS

- WHERE ARE THEY IN THE PROCESS
- CAN THEY BE ISOLATED/MEASURED
- WHAT IS THE ROOT CAUSE/DRIVER
- ARE THEY ADDING VALUE
 - Do they apply to your work
- CAN THEY BE ELIMINATED/MODIFIED

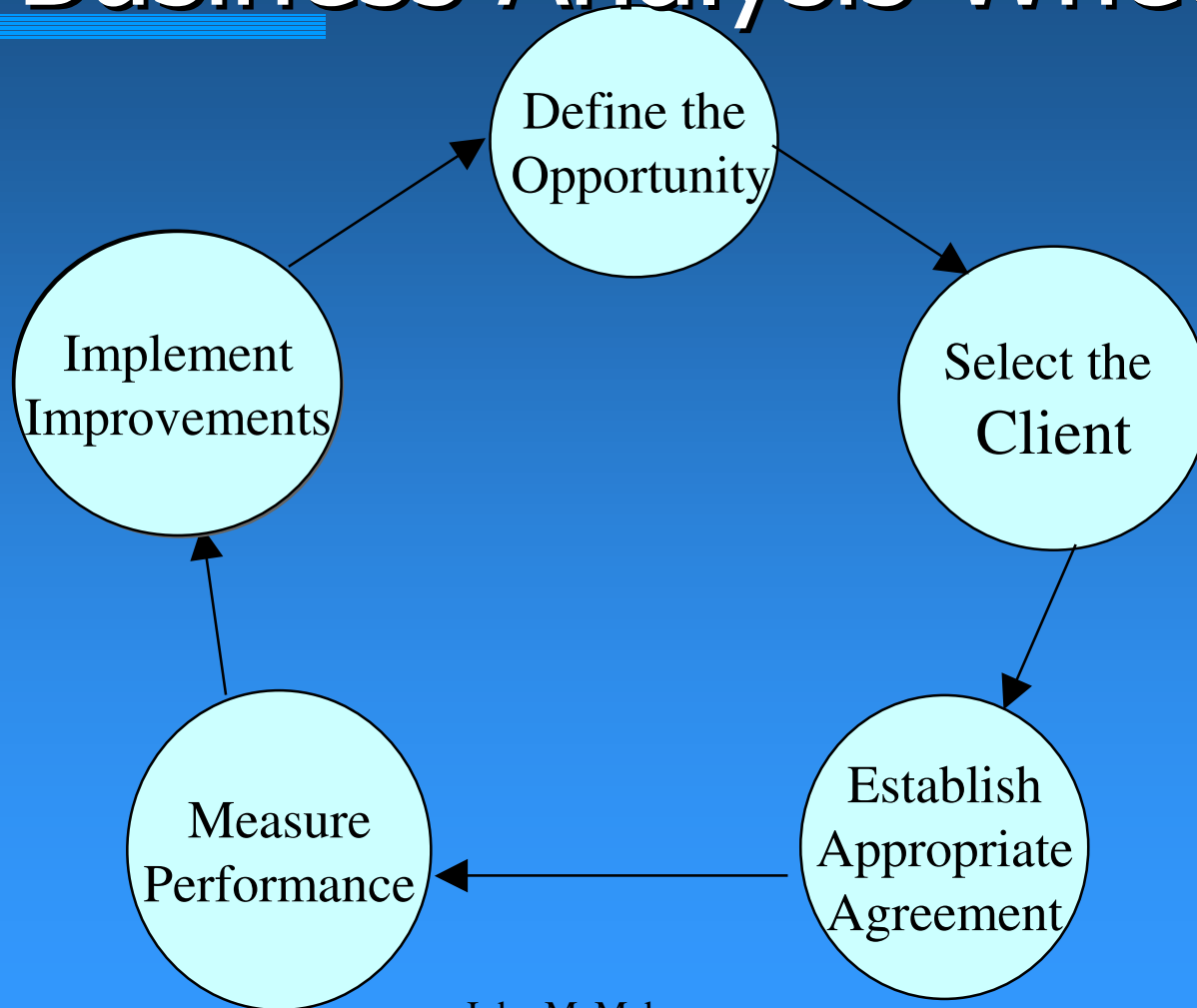
Contract Services Example - Uniforms

- Assumptions :
 - 100 person operation
 - \$13.50/week uniform cost
 - \$7.00 lease, \$6.50 cleaning
 - 40% utilization of cleaning service
- Annual cost - \$70,200
- Non-value add cost \$20,280
($\$6.5 \times 100 \times .6 \times 52$ weeks)

TARGETING THE OPPORTUNITIES

- PRIORITIZE THE COMMODITIES/SERVICES
- SELECT THE SUPPLIERS/CUSTOMERS
- EDUCATE YOUR CUSTOMERS/EMPLOYEES
- EDUCATE THE SUPPLIER BASE
- COMMITMENT TO GOALS AND MEASUREMENTS

Business Analysis Wheel



In Negotiations

■ Knowledge

- A Potentially Powerful Tool
- Requires Action
- **MONEY**

■ Assess Your Knowledge Base

- Take Appropriate Action

■ Form A Functional Team

- Internal and External Resources

SCAN PROCESS

- SCOPE
- CONSULT
- ANALYZE
- NEGOTIATE

SCOPE

Define the scope of the work,
contract, commercial implications, and
value

Consult

Utilize **ALL** (appropriate) resources

Analyze

Calculate the true cost and value

Negotiate

Leveraging information gained above to design the **Lowest Total Cost** agreement

Leveraging information gained above to design the **Highest Value Add** agreement

BASIC COST MODELS

■ FIXED COST

- CONSTANT IN TOTAL/ PER UNIT BURDEN VARIES PER USAGE

■ VARIABLE COST

- CONSTANT IN VALUE/VARY PER UNITS USED

■ OPPORTUNITIES/EXPOSURES

Tank Cleaning

- Unit Rate Agreement
- 10 hours/day @ \$3,000 per day
- Required Over Time work
- Requested Rate for Additional Hours
- Contractor Response \$300/hr
- Negotiated Rate \$176/hr based on variable cost
- Cost Savings \$36,500 (3 weeks @ 14hr/day) 24% reduction in total cost

Case Studies

- Filter Press
- Contract Packaging Labor

FILTER PRESS

- Long Term Use of Mobile Unit
- 24 HR/DAY 7 DAY/WEEK OPERATION
- SUPPLIER RECOMMENDATION WITH CATCH
- DIRECT NEGOTIATIONS
- ANALYSIS OF COST DRIVERS
- \$16M/MONTH COST REDUCTION

Supplemental Labor/Packaging

- Fixed Monthly Fee -\$77M/Month
- Contractor Document Claiming Losing Money
 - \$11M/Month Price Increase
- SCAN Process

Supplemental Labor/Packaging

- Supplier Audit
- Negotiated Service Agreement
- PFP Agreement
- Cost Reductions/Quality Improvements

Total Cost Management Result

- Increase in labor unit rate \$2/hr
- Reduction in total number of laborers (4)
- Reduction in overtime hours (45% to less than 10%)
- Improved quality (reduction in scrap by 1MM pounds @ \$2/# = \$1MM revenue/profit)
- Pay for performance cost \$45K

Keys to success

- Know your client needs and contract
- Know your cost drivers
- Know your **client's** cost drivers
- Get current information on performance and cost improvement programs/initiatives
- Engage the client
- Educate the client and the workforce
- Stay focused
- Report key information/improvements

Alliance Agreements

From the Contractor's View

- An agreement for cost reduction where the client has the authority to modify compensation and work requirements with minimal notice. Where the agreement may be terminated without notice or cause if the operations personnel find better pricing or if a work task does not meet financial targets, regardless of cause. (cont.)

Contractor's View (cont.)

- Where the service provider is required to supply all necessary resources deemed necessary without additional compensation. Where the client is not required to modify any cultural or operational activities regardless of actual or potential benefits to either party, unless the client can gain additional financial benefit at the cost of the service provider, while making minimal temporary adjustments to internal actions.

Client View

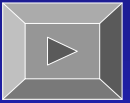
- A long-term sole source, restrictive contract, negotiated by Purchasing, that requires substantial modifications to existing practices, that primarily benefit the supplier. Additionally, the supplier will work with a lower sense of urgency due to a “locked in” attitude and will demonstrate tendencies of lower productivity, poor quality, and rate and personnel creep. (cont.)

Client View (cont.)

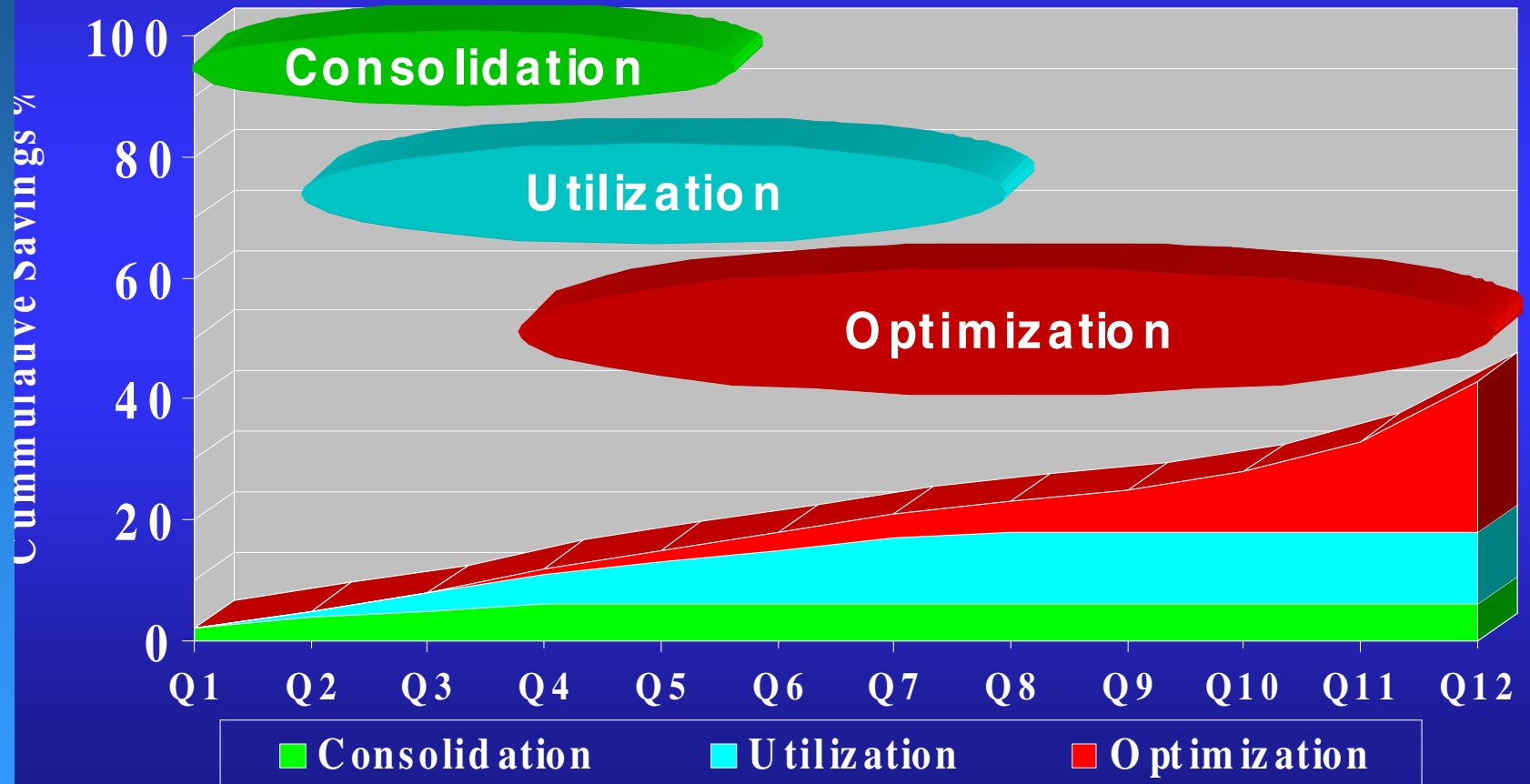
- All of which, in the end will cause higher cost and will expose the operations to greater risk during emergency situations and shut downs due to the reduced availability of alternative suppliers and resources.

Alliances Defined

- A long-term, mutually beneficial agreement between two or more partners, in which resources, knowledge, and capabilities are shared with the objective of enhancing each partner's competitive position. (Alliances and Partnership Strategies)



Phases of Managed Services



Total Cost Management

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