A HISTORIC LOOK AT HOW SOME COMPANIES HAVE CUT COSTS WHILE GAINING THE COMPETITIVE EDGE

Cost Management Comes of Age in Russia

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FROM 1998 TO 2008, MANY Russian and international companies witnessed annual sales growth of 20-30 percent. During this time, expats would request transfers to Russia so they could have some of this growth on their resumes. Many believed that this rate would never end, as oil prices would continue going up forever, much like housing prices in the U.S. Since last September, the entire business environment has done a complete reversal. Instead of regular seminars on how to attract and keep employees, as we were attending only several months ago, we now take part in seminars on how to lay off staff with a minimum of legal risk and how to reduce employee benefits. In December there were many stories about how companies were scaling back holiday parties for employees. These responses to the economic crisis represent a form of cost cutting that is a normal reaction to any economic downturn. In contrast, cost management represents a core strategic objective for a company.

Cost management consists in the knowledge of where company resources are used and to what purpose, in to order to determine what additional financial resources are necessary, and for what; it is also used to ensure the highest possible efficiency level of resource use. Cost management also consists in the ability to save resources and maximize their efficiency. Various studies have demonstrated that for one dollar of cost reduction it would take six dollars of additional sales to achieve the same increase in the profit of a company. While many companies may already have good cost management practices, some leading companies in the area of cost management will be doing business in Russia in the near future.

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> **– Sam Walton**

Cost Management Examples

Dell, Inc. is a great American success story. In 1984, Michael Dell began assembling computers in his college dormitory. By 2008, his company was generating over $60 billion a year in revenue. Dell was always a company that focused on cost management as a core competency. In its early years Dell did away with its network of distributors and sold computers directly to customers by phone and later on the web. This reduced the cost of its computers by about 15 percent. Dell pioneered the concept of "demand pull" production, whereby the assembly of a computer was not initiated until the customer actually ordered it. This technique had a number of advantages. First, the computers could be assembled based on actual demand rather than a sales forecast. No extra computers needed to be produced and held in inventory. Secondly, computers could be assembled according to customer specifications. The "demand pull" concept greatly reduced the cost of storing inventory that did not provide value for the customer. In conjunction with "demand pull" Dell mastered the use of the "Just in Time" method of production. Today, Dell assembles computers and buys components from a number of suppliers (Sony, AMD, etc.). It organizes the delivery of the components in order to be "just in time" for assembly in a particular computer. This system reduces inventory and carrying costs, while providing Dell with new-technology components and at lower costs.

Another example is Wal-Mart. When Wal-Mart began business in 1962 its motto was "Every Day Low Prices." This philosophy has been fulfilled for the last forty-six years. Its 2008 revenues were over $400 billion. Founder Sam Walton succinctly stated Wal-Mart's mission: "By cutting your price, you can boost your sales to a point where you can earn far more at the cheaper retail price than you would have by selling the item at the higher price. In retailer language, you can lower your markup but earn more because of increased volume."

From its beginning Wal-Mart imposed strict control on overhead costs such as rent, and in the early years much of the profit was reinvested to improve distribution and to increase the efficiency of purchasing. Wal-Mart has always been a pioneer in the use of information technology to improve the supply chain management of the retail business, and by 1979, it had developed the first fully automated distribution center. Today, Wal-Mart utilizes an EDI system that allows suppliers online access to Wal-Mart's inventory records. The supplier has the capacity to replenish inventory when it is below certain levels. This system greatly reduces loss due to stock outs.

The most innovative technology that Wal-Mart is currently implementing is radio frequency identification technology (RFID). RFIDs' are micro computer chips that are attached to the products purchased from suppliers. RFIDs send Wal-Mart dispatchers stock information about products. For example the RFIDs can send information on how much product is on each shelf and when the shelves need to be replenished. They can provide great value in at least two areas. First if fully implemented, they can eliminate the loss of sales from stock outs and they eliminate the need for Wal-Mart employees to continuously check inventory levels. This results in significant cost savings. When the use of RFIDs is fully implemented, Wal-Mart estimates a cost savings of $8 billion annually.

Toyota's Kaizen Philosophy

Toyota has been producing cars in Russia since 2007 and is the ultimate model for cost management practices. In spite of recent operating losses Toyota has become the largest automaker in the world. The driving force of the company's success is the implementation of the "Kaizen" (continuous improvement) philosophy – continuous improvement in one's personal life, home life, social life and working life. When Kaizen is applied to the workplace it means continuous improvement for managers and workers.

Kaizen has been manifested at Toyota in many ways. Toyota's own "just in time" production system was designed to eliminate the unnecessary movement of materials and products, excessive inventories, the production of defective products, and the superfluous re-locating of people. As a result, Toyota's production costs have been significantly reduced. Toyota was one of the first companies to implement a target costing system of production, requiring that the cost of a vehicle being produced be determined at the design stage before production begins. The underlying assumption is that there would be a continuous reduction of costs. Target costing gives Toyota the ability to predict and control the costs of production.

Total Quality Management

Total quality management (TQM) emphasizes the reduction in defects in the production process. The assumption is that producing products with a minimum of defects reduces such costs as warranty costs. TQM was developed by Edward Deming in the early 1950s. Deming tried to persuade U.S. automakers to adopt TQM, but was rebuffed. TQM was embraced by Toyota and has since become an essential component of Toyota's production system.

All of the companies I have discussed are benchmark companies in their particular industries and have utilized cost management techniques as a driver for their success. These cost-management practices were not developed quickly and are effective because they were applied with disciplined and consistent execution.

In these troubled economic times, companies can no longer expect a 20-30 percent increase in revenues. Companies should learn valuable lessons from the best cost-management practices of Dell, Toyota, and Wal-Mart, and in turn use the difficult times as an opportunity to establish their own cost-management practices. They can re-emerge as stronger and more efficient enterprises. As one of Kaizen's axioms teaches us, "Wisdom is revealed when faced with hardship." ■