

// Dealership Management

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Cost Reduction Approach – Tactical or Strategic?

// CURRENT COST CONTROL CHALLENGES

Most business organizations find themselves involved in cost reduction initiatives from time to time. To sustain an organization over the long term, cost reduction efforts need to become deeply ingrained in the business structure itself and that is usually accomplished through a Spend Management or Purchasing Department. Purchasing is typically charged with sourcing, quoting, negotiation, implementation and supply base management responsibilities including compliance audits.

TACTICAL APPROACH

While many cost reduction efforts focus on headcount initially, often those efforts move into the supplies and services that all business consume and are required to support their operation. The supply and service arena is usually the last area of focus by dealerships for the following reasons:

- ▶ Complex area to tackle
- ▶ Efforts not well organized
- ▶ Too many suppliers
- ▶ No centralized

approach to manage supplies and services

- ▶ Staff not trained properly
- ▶ Processes and tools are not readily available

When dealerships attack their supply and service expenses, they tend to use a very tactical approach. Selected managers are frequently entrusted to pick out an expense category and talk to their current suppliers about renegotiating pricing. If management comes back with a 5% decrease in pricing, everyone feels good and they repeat the process. It is now up to the next manager and hopefully they will achieve a similar result. These tactical approaches to cost reduction provide temporary relief, but usually do not provide long-term, sustainable benefits that move the expense and profit needle to any degree. The problems with the tactical cost reduction approach include the following:

- ▶ Short-term pricing – not locked over the long term
- ▶ May not include business terms and processes
- ▶ New pricing may not include the entire scope of items or services purchased
- ▶ Not well documented so auditing becomes impossible

Tactical approach will frequently overlook other expense categories. Most organizations tend to focus on price as the primary lever or strategy they pursue to reduce costs. A focus on price is a fairly typical approach in a decentralized environment when time is short, staffing is thin and results are needed quickly.

STRATEGIC APPROACH

In virtually every industry and business, a Spend Management or Purchasing Department is in place to plan, control and manage expenses. 95% of dealerships do not

have that structure based on our experience. However, even though a formal Purchasing Department is not in place, the organization can still operate in a similar fashion and realize many of the same benefits, it just takes a bit more coordination and a lot more communication to generate results.

STRATEGIC APPROACH IN A DECENTRALIZED ENVIRONMENT

For organizations running without a full-time Purchasing Department, the following strategy and steps should be taken to realize more sustainable cost reduction results (see *chart 1*).

- 1. PLANNING** - Understand what you spend and with whom – Build a spend map
- 2. SET OBJECTIVES** – Set up aggressive cost reduction objectives
- 3. DEVELOP A SOURCING PLAN**
- 4. BUILD A TEAM** – Assemble a team from

CHART 1



your managers to execute the plan

5. TRAIN YOUR TEAM – to learn how to quote and negotiate

6. EQUIP YOUR TEAM – Provide the guidance, tools and communication vehicles for success

7. MANAGE FOR RESULTS – Execute, measure, manage and report

BENEFITS OF A STRATEGIC APPROACH

A strategic approach to spend management will typically provide a greater payback than a tactical approach and will include the following benefits:

- ▶ Methodical approach to sourcing all categories
- ▶ Defined process such as five levers will yield long-term benefits vs. short term
- ▶ Fixed pricing approach allows for audits and improved supplier compliance
- ▶ Fewer suppliers to manage
- ▶ Greater cost reductions and improved profitability

KEY SOURCING STRATEGY OR TOOL – FIVE LEVERS OF EXPENSE MANAGEMENT®

I have introduced the Five Levers approach before, but it is particularly appropriate for a team that is beginning to execute a cost reduction plan. The Five Levers strategy is a combination of proven purchasing practices and operational strategies, sound supplier audit practices

and a proven strategy to reduce your costs on a sustainable basis.

The Five Levers approach depicted below is a process or tool that your management responsible for procurement, should use for all sourcing projects going forward. This tool is designed to provide the right solution to meet the actual needs, at the right cost.

STRATEGIC APPROACH – APPLYING THE FIVE LEVERS APPROACH:

LEVER I - REQUIREMENTS: Rather than just renewing your waste agreement at a new price, dig a bit deeper. What size container do you really need? What is the best container size and frequency of pick-up required? Once that is known, then it is time to move to the next lever.

LEVER II - SOLUTION: Do you need one supplier or multiple suppliers? Should you open up category selection (office supplies) to employees to order anything they want, or should you limit those choices (to a limited core list)? Should you standardize on low cost alternatives or allow the purchase of more expensive branded items?

LEVER III - FINANCIAL: Everyone focuses on price, yet it is but one component of the entire transaction. Secure a good price....and lock it.

Secure favorable business payment terms with early payment discounts. Negotiate favorable delivery terms and protect the pricing and terms for sustained periods of time.

LEVER IV - PROCESS: Price is important, but so is the process related to the acquisition and payment of the product or service. Should you order via internet? Should you pay the invoice with a credit card? Should your team be pulling three credit bureaus at one time because it is easier? Process considerations must not be overlooked when you select and implement a new supplier and program.

LEVER V - COMPLIANCE: A lot of good, thoughtful work goes in to creating an effective solution. If the levers listed above are followed, the solution should be auditable. Supplier compliance audits focus on ensuring that price and business terms are adhered to by the supplier. Another form of compliance is to ensure that your employees are using the designated suppliers and running off and using some new solution.

SUMMARY
If ownership and management is really serious about impacting and controlling expenses, the current tactical approach to cost reduction needs to change. Tactical, short-term cost reduction efforts

often resemble fire-fighting. Put out the fire and move on to something else. Then when sales dip, re-organize the team and repeat the effort to feel good about impacting expenses....but the needle never really moves in a material way.

The more strategic approach would require building an internal Purchasing Department that is an ongoing resource. A Purchasing Department should pay for itself and more over time. If that approach is not possible for your organization, you should at a minimum employ the Five Levers approach to generate sustainable results at the category level. Once organized, those responsible for sourcing and procurement should employ the "Five Levers" approach to their sourcing initiatives. The Five Levers of Expense Management strategy is more time consuming than spending a few hours on price negotiations, but the results will certainly be worth the effort.

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