Proving Total Cost Savings

UID Course 021

What is the one thing every customer is looking for…the means to reduce their operating cost and improve profits. To achieve this, most customers focus on a lower price paid from their suppliers. Unfortunately, it is also the primary cost driver that sales people know how to measure, and is often the easiest savings for a supplier (distributor or manufacturer) to sell on.

But a lower price does not always equate to the lowest total cost. In fact, lower priced products can actually reduce the customer's operating profits through hidden or misunderstood costs. Salespeople often "know" this, but fail to prove the savings their services and better fit to function products could provide.

And while it is true that some of your customers may know you are worth more than the lowest price paid, others within the organization may not and are questioning just how much more are you worth…a 2% premium, 4%, 5%? Proving the savings from all of the solutions you provide helps to prove you are worth the premium, and increases the customer's risk for not keeping you as the supplier of choice.

But documenting and reporting savings offers the salesperson so much more. Reporting what you have done for a customer can help you keep the account when new buyers take over the purchasing, corporate management decides to cut costs, and/or a new supply chain director wants to move in a different direction. It can be used to create a barrier against competitors winning the business away from you.

And of course, it can be used to help win new accounts and penetrate existing ones further. Because every customer wants to save and the supplier that can prove the savings to them can gain more sales. Which in turn can lead to higher compensation for the salesperson.

While proving total cost savings can help you sell more, the focus of this course is NOT on selling (consider UID course 006: Creating a Competitive Distinction for the sales aspect of your solutions). The focus for this course is on how you can measure the savings from the products and services you provide.

Unfortunately, the term value added is often over used. Almost every salesperson tells the customer that their company adds value. But if you asked 5 salespeople what value added means, you would get 5 different answers…even from the same company.

For me, and most of your customers, value added means that you provided a product or a service that makes the customer more profitable. This can come from either increasing the customer's revenues or decreasing their costs.

So, if a supplier adds value only when they do something that makes their customer more profitable it becomes critical to be able to identify not only the costs impacted, but the actual savings derived from these cost reductions. And to get acceptance to these savings, you want to follow standard cost accounting principles. Which means you have to start with the Profit and Loss Statement.

There are three categories of profit impact a supplier can effect:

1. Revenues: minimized downtime, increased production rates, reduced rejected output or other changes that increase the customer’s sales, or profit from sales.
2. Expenditures: reductions in the price paid for products/services, energy costs, utilities, disposal, freight, or other aspects of annual spend.
3. Processes: a reduction in personnel costs due to the elimination or minimization of tasks needing to be performed.

There is a fourth category that can be related back to the Profit and Loss Statement: assets. Assets appear on the Balance Sheet, but have a cost associated with each asset known as a possession cost:

4. Assets: reductions in possession costs when inventory, equipment or facility requirements are minimized.

The possession cost of an asset is the easiest way to measure the value from asset reductions. For example, inventory reduction can reduce interest expense, storage, handling, taxes, shrinkage, and other costs. Instead of trying to measure every cost, companies assign a value to the possession of the inventory often referred to as carrying cost.

To measure the value your solutions impact, it is critical to accurately determining which categories are impacted by a value-added solution. Suppliers should also track both the value they have already added and the value they could add. Determining the value that has already been added can help create a “firewall” to minimize the possibility of competitor “poaching” a customer. Demonstrating to customers the potential value of a solution can help the supplier obtain additional sales from an existing account or act as the means for gaining sales from a new account.

One of the key points to remember when measuring the savings, is that value added opportunities requires the customer to change in some way and have the supplier do something for them. For example, with Vendor Managed Inventory the supplier takes over managing the customer’s inventory, or with energy/leak audits the supplier assists in finding ways to reduce energy costs, or leaks in production lines or steam pipes. Suppliers add value when they work with the customer to make a change. If the customer does not change, then there is no value added. This is a critical aspect of being able to measure the value a supplier adds because it is the change in the customers operating costs and revenue that allows you to measure the value you have added.

Measuring the financial impact of a change is not new for most customers. In fact, there is a whole field of study in accounting called Cost Accounting that measures the financial impact within a company when a change is proposed or made. Most companies use these Cost Accounting principles for making financial decisions around large expenditures or projects, but Cost Accounting can be used to measure any change. Measuring value added is simply extending Cost Accounting to include smaller changes provided by the supplier.

But being able to capture the savings you have provided or are offering to provide, does not just help your customer. It can help you to keep strategic accounts, win new business and increase compensation. It helps you to create a competitive advantage, because while everyone else is claiming to add value, you are proving it.