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## 5 Places to Find Money on a Cost Breakdown

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In our desire to buy at the lowest price and learn more about the cost drivers of the products we buy, many of us require suppliers to provide detailed cost breakdowns as a part of their quotations. The breakdowns capture suppliers' costs and manufacturing information including raw material cost, labor rates, number of operators, burden rates, scrap percentages, SGA and Profit margins and much more. Based upon our experience here are the top 5 areas where we have found savings opportunities:

- **Raw material credit** – All manufacturers know that the cost of raw materials has skyrocketed over the past few years, leading many suppliers to demand raw material increases. However, what many need to realize is that raw material scrap has also increased along with raw materials. This has allowed suppliers to resell this scrap for increased revenues. Since the customer is the one paying for the raw material scrap, they ought to be receiving the increased resale credit for it. To make sure we are receiving proper offset we need to make sure that the cost breakdown capture raw material scrap resale as credit towards the piece price.
- **Purchase components markup** – Many times suppliers mark up purchased components another 5% - 25% and pass that along to the customer. Most of these components are typical day to day components such as clips, seals, tape, etc. where market research would validate the components cost. Spot check purchase component costs to see if they may be extreme. Also ask for invoices to verify these cost if necessary.
- **Overstated Labor Rates** – Suppliers will build in “extra costs” into their labor rates and quote a higher rate than what they are actually paying. If you feel the supplier rates may be high, research the U.S. department of labor for typical labor rates in the region (if in the U.S.) and measure against what the supplier is quoting. Also, compare labor rates of the supplier's past cost breakdowns with current cost breakdowns to see if they are consistent in their rates.
- **Inconsistent SG&A rates** – SG&A rates on quotations can vary substantially. We routinely see rates from 3% to 15% (of Total Manufacturing Cost). Many of these suppliers are publicly traded companies which report SG&A rates openly. Compare what suppliers are quoting on their cost breakdowns to what they are reporting publicly. Ensure these numbers are consistent and if not challenge the cost breakdowns accordingly.
- **ED&D Costs** – Engineering, development, and design cost is an area that has been difficult to verify, but one way of doing this is by annualizing the costs and determining whether this is reasonable or not. For example, we recently came across a scenario where a supplier quoted a cost of \$1.98 per part for ED&D. The volume for this simple part was around 200,000 annual units. This meant the customer was paying \$396,000 per year ( $\$1.98 \times 200,000$ ) in ED&D cost just on this part alone. Assuming a design engineer salary is \$80k/yr, this meant the supplier was quoting approximately 5 fulltime engineers dedicated only to this part. It turned out the supplier only had 4 full time engineers working in this department. ED&D costs should only represent the cost associated with the part.

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