Top Mistakes Suppliers Make When Developing Customer Quotations
How Companies Can Avoid Them and How Buyers Can Spot Them

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Executive Summary

Cost transparency from a knowledge-based approach to purchasing helps suppliers avoid 10 costly mistakes. This paper summarizes how to move from minimal levels of cost knowledge to open book costing based on production costs. It identifies the 10 costly mistakes suppliers often make and describes how buyers can counter them.
Background

Many manufacturing buyers and sellers struggle with the belief that buyers should always ask for detailed cost breakdowns and sellers should always try to avoid providing them.

At the Purchasing Authority, we are committed to a collaborative, knowledge-based approach to purchasing. As far as pricing is concerned, we are talking about the deep knowledge of the cost of manufacturing the products that are being purchased.

We favor this approach because this deep cost knowledge fosters a more collaborative relationship with suppliers and requires fewer suppliers in the supply chain. The alternative to this knowledge-based approach is a competitive price approach, where the buyer does not try to understand the cost structures, but buys based upon price, not the underlying cost competitiveness of each supplier.

Benefits

The major benefits to obtaining a detailed understanding of cost drivers are:

- **Fewer suppliers are required.** Buyers who buy on price alone need to have an ample number of suppliers to foster competition when purchasing new products. This competition drives purchase prices down.

  Alternatively, the buyer with a deep understanding of supplier cost structures can match the right part to the right supplier using the knowledge of the suppliers’ cost structures as the objective criteria for establishing pricing.

- **It is easier to control pricing as economics and design change.** In manufacturing, buyers are often sourcing parts long before they go into production. During the sourcing to production time span, economics and design often change. The buyer who sources on price alone has difficulty understanding if the supplier’s revised pricing due to a design revision is fair or not, while the buyer who has the deep understanding can use it to establish a fair price for the revised design.

- **Buyers can validate supplier quotes.**

- **A pricing adjustments methodology can be established.**

- **It serves as a basis for collaborative relationships and tools.**

  See Figure 1 for more details.
Purchasing organizations have varying levels of cost knowledge, from minimal, based only on price, up to open book costing, with deep knowledge of production costs:

- **Price** – buy on price alone.
- **Cost breakdowns** – buyers receive cost breakdowns from suppliers and utilize them to establish initial pricing and adjustments.
- **Cost estimates** – purchasing may have a cost estimator that assist in the analysis of supplier detailed cost breakdowns.
- **Cost models** – buyers can use the information on the detailed cost breakdowns to develop “should be” cost models.
- **Open book costing** – buyers review each suppliers’ actual costs of production and develop “should be” cost models for each supplier.

Our history with cost reduction engagements shows that with each step up in cost knowledge, the buyer’s positive cost impact increases. We have charted this on the cost transparency curve in Figure 2.

### Individualized Strategies

Rather than believing that all commodities should be bought on price alone or that all commodities should be open book costed, we believe that each commodity being purchased should be analyzed on its own and that a pricing/cost strategy should be developed for each. This calls for a mixture of tools (see Figure 3).

### Top 10 Mistakes Suppliers Make

Based on more than 20 years of experience in manufacturing purchasing, we see these 10 mistakes suppliers make:

1. **Not understanding if the buyer is using cost breakdowns as a collaborative tool to reduce costs or as a competitive negotiation tactic.** For success in negotiations, each party should understand if the other is negotiating with a collaborative or competitive approach.
Buyers who are negotiating with cost breakdowns as a competitive tool:

• Accept the inconsistencies in quotations that are identified in #2 below.
• Ask for a revised pricing and then accept it without asking: “What did you do to achieve the lower cost structure?”

**Buyers who are using a collaborative approach:**

• Provide feedback on cost structure competitiveness.
• Use cost breakdowns as objective criteria in future pricing discussions.

2. **Not having a good shop floor costing system that ties actual costs of production to customer quotations.** All manufacturers should have robust cost methodologies that track actual costs of production on a continual basis. They should use these as the basis for developing customer quotations. Our experience, based upon the creation of more than 900 open book cost models, is that many/most do not. Without this, suppliers tend to:

• Have widely varying profits on individual parts
• Have inconsistent pricing and costs on customer quotations
• Make mistakes/corrections on quotes
• Have a re-pricing history with their customers that hinders their ability to win new business
• Change pricing easily when pressed by buyers

**3. Using plant-wide burden rates.** As an example: Instead of developing process-specific burden rates, a manufacturer uses an across-the-board stamping, welding and assembly burden rate of $50 per hour. However, the actual costs look like this and are representative of competitors’ costs:

![Figure 4](image)

<table>
<thead>
<tr>
<th>Burden/Overhead Cost by Department</th>
<th>Total Cost</th>
<th>Machine Hours Available</th>
<th>Cost per hour</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stamping</td>
<td>$4,500,000</td>
<td>45,000</td>
<td>$100.00</td>
</tr>
<tr>
<td>Welding</td>
<td>$2,000,000</td>
<td>30,000</td>
<td>$66.67</td>
</tr>
<tr>
<td>Assembly</td>
<td>$2,400,000</td>
<td>100,000</td>
<td>$24.00</td>
</tr>
</tbody>
</table>

This manufacturer would win business awards for parts that are only for stamping with very low profit margins but would not win work with a high assembly component.
4. **Having the same burden rate for different sizes of equipment.** As the size of equipment goes up, so do the costs of power consumption, depreciation, replacement parts and a whole host of other costs. Suppose a manufacturer’s costing system does not recognize this and uses the same $100 per hour burden rate regardless of the press size. If actual costs shown below in figure 5 are representative of competitors’ costs, then this manufacturer will win business awards with low margins on the large presses but will not win business awards on small presses. As a result the large presses will be overloaded with low margin business while the small presses will sit idle due to a lack of business.

5. **Burden and SG&A rates that vary widely over a short period of time.** For example: A quick audit of historical quotations using the same press size revealed that the supplier had used rates of $175, $150, $125 for the same press, all within the last year.

The supplier’s rationale for the discrepancy could have been: “Look, the previous buyer just asked us to meet pricing and was not really concerned with the amount we put in burden to meet the pricing expectations.” Where does that leave the supplier in the discussions with the new buyer?

To avoid this, manufacturers should develop annual rates based upon last year’s cost history, adjusted for changes and applied using this year’s volume.

6. **Labor costs which are inconsistent over time and/or for the region where they are located.** For example: A quick audit of quotations from suppliers in the same industrial park in a low-cost country revealed a 47% difference in labor rates.

To avoid this, manufacturers should always know the labor cost of their competitors and of the other companies in their same geographic regions.

7. **Inaccurate and inconsistent cycle times.** Cycle times can be tricky. Buyers ask suppliers to develop quotations that will be used to agree upon pricing. Oftentimes, cycle times are then estimates and actual times may vary (this can also be said for items like efficiency and scrap).
To become more accurate in the quotation process, the estimating methods and results need to be constantly checked and updated against the actual experience.

8. **Neglecting tooling.** We often find that manufacturers do not exert the same effort to improve tooling cost competitiveness as they do production costs. The most cited rationale for this is: “Well, the customer pays the tooling, so it is just a pass-through.” Why, in such cases, should the manufacturer be looking at the tooling?

- For some commodities, understanding the total ownership cost of tooling, including price, quality, maintenance and tool life is key to the ongoing financial success of the company.
- The buyer should be factoring the cost of tooling into the financial evaluation used to select the production source.

9. **Inconsistent component costs.** For example: A quick audit of quotations from the same supplier but to different buyers and from different sales people revealed a 20% variance in the cost identified for the same subcomponent. This came as not only a surprise to the buyer but to the supplier as well. The supplier lacked the ability to quickly check where the items they were buying/including in their product were being sold.

10. **Inconsistent/Inaccurate Profit margins.** Oftentimes when reviewing a client’s historical detailed cost breakdown quotes, we find similar parts sourced to the same supplier with a wide range of profit margins or quotes that have little or no profit margin. These should be viewed by the buyers as red flags to be investigated. As a part of the quoting process, suppliers should report realistic and consistent profit margins.

**Building Cost Transparency**

If these are the top mistakes suppliers make, what should buyers do to maximize the benefits of obtaining cost breakdowns?

- **Use cost breakdowns as a collaborative tool** to understand and manage costs, not as a competitive weapon to drive down pricing. Either method will drive down pricing. However, only one builds a collaborative relationship that will lead to buying at the lowest costs.
- **Track the key cost drivers for each commodity** for which the buyer is obtaining detailed cost breakdowns; compare with each quotation received. Some examples:
We refer to such detail as building cost transparency. We believe that a transparent, highly professional, and collaborative approach to procurement brings not only substantial financial rewards but also allows well-informed people to operate in a thriving environment.

To learn more about how we help companies achieve cost transparency with minimal impact to workload, call Mike Betz 734-927-0836 extension 102; or email him at mbetz@apurchasingd.com.

Figure 6 shows how to spot tooling costs that are too high.

Figure 7 identifies how to compare labor rates in geographic regions.

Figure 8 shows how to spot the supplier using the same burden rate for each size press.
About APD, the Purchasing Authority

Advanced Purchasing Dynamics (APD), the Purchasing Authority, provides manufacturers with market-leading solutions to streamline all facets of procurement and purchasing operations. Companies partnering with APD benefit from six service components: SYRE purchasing software, cost engineering, training, placement/recruitment, consulting and Service Delivery & Optimization of purchasing processes. APD’s SYRE cloud software solution and precision cost engineering services deliver a real-time assessment of supply chain operations and identify ways to streamline processes and lower costs. Manufacturers gain value through APD by “should be” cost modeling, and automated purchasing analytics and reporting, resulting in improved decision-making. With the Purchasing Authority, enterprises decrease costs and improve bottom lines. Visit apurchasingd.com for more information.

About the Author

**Jeoffrey Burris**, Founder and Principal of Advanced Purchasing Dynamics

Jeoff founded APD after spending 20 years in the automotive field where he became a recognized authority on procurement processes in the industry. A noted builder of high performance teams, Jeoff led purchasing staffs at Ford Motor Company, Metaldyne and Inter Automotive Seating where they were able to consistently save money on procurement costs and significantly improve related processes as well.

In addition to developing a deep understanding of purchasing in the automotive industry, Jeoff became a successful global manager, running profitable facilities and joint ventures in India, Korea and Mexico.

In 2004, the time was right for Jeoff to bring his passion for discovering optimal procurement solutions to his own firm. He infused APD with methodologies for true cost model engineering - approaches to evaluate global sourcing options while performing precise, customized risk and opportunity assessments for valued clients.

At APD’s Plymouth, Michigan headquarters, Jeoff believes in forging a better, more collaborative relationship with suppliers. His techniques also improve the entire organization, not just the purchasing department. He remains a key figure in the world of procurement and global sourcing.