

REVIEW EXERCISES

1. Describe the three key elements of strategic cost management and how they are related to each other.
2. Why is it important for key decision makers throughout the organization to understand the value proposition for the situation they are working with?
3. When can a high level for a cost driver be desirable? Give an example of a situation (real or hypothetical) when a higher cost decision is better for an organization than a lower cost decision.
4. Who should be responsible for strategic cost management in an organization, and why?
5. What are the problems with most managerial accounting systems today? How does ABCM address these problems?
6. Describe TCO analysis, and where it is applicable.
7. Why is it important to have a team involved in conducting TCO?
8. When conducting TCO analysis, what is sensitivity analysis? Why is it important? When should it be conducted?

Case *The Costly Packaging Decision*

Selena Diaz felt she had a real opportunity on her hands. She was in her second job rotation of her SCM training program at Noette, a global consumer products manufacturer. Her manager, Wu Li, had explained their packaging problem to her: "We have very long lead times on the plastic packaging for our Noette Platinum skin care line. Because we change the labeling, the style, the sizes, and color offerings of products quite frequently, packaging lead time significantly affects time to market for new products. We don't have a long product life cycle. Further, when we drop a product, any packaging in inventory becomes obsolete. This is costing us about \$500,000 a year. In addition, we sometimes have to ship the finished product by air due to the production delays caused by waiting for the packaging material. This costs us another \$400,000 a year.

"From a marketing standpoint, it is critical that we adapt our production schedule very quickly, as soon as product demand is realized. But it is often difficult to determine the demand for new products. If we do not have the products available to sell the consumers in the marketplace, we could lose the sale forever. This could cost us millions. We just don't know how much. Ideally, our response time for packaging should be very rapid. This would minimize the risk of lost sales and airfreight charges, as well as the risk of write-offs due to obsolescence. Don't even think about standardizing the packaging or using some cheap labeling technique. This packaging is a critical part of the product's image. Marketing would never stand for it. Take a look at the supply chain and come back to me with ideas for improvement."

Selena had talked with manufacturing, the suppliers, and marketing, and sketched the supply chain in Figure 8.5.

Selena learned that Noette's Platinum skin care products are packaged in specialized high-quality tubes. The label is first printed on "web stock," which is then laminated onto the tube so the words will never rub off. Noette sees its packaging as adding value in quality, image, and even safety because the tubes carry the usage instructions. The tube supplier was chosen to provide a unique, high-quality packaging that fit the image of this upscale cosmetic supplier.

Currently, the need for the tube order is identified when the MRP (materials requirements planning) system is run. This takes approximately 1 day. Next, about half a day is used in placing a purchase order (PO) with the tube supplier, and another half-day in the supplier's scheduling process. Now the queuing process begins. The tube supplier places the PO to schedule printing of the web stock with the label supplier. There is about a 14-day wait until the web stock label is printed.

Printing then takes one day and the label supplier ships the web stock to the supplier of laminated tubes in New Jersey. At this point, the order enters a queue at the tube supplier's manufacturing facility, where it waits for 23 days. After this time, the tube supplier makes the tube and applies the web stock, laminating it to the tube. This takes about 2 days. The tubes are then shipped by truck and boat to Noette's manufacturing facility in Puerto Rico, which takes another 7 days. The current process takes 49 days, from the time the packaging need is identified to the time the tubes arrive in Puerto Rico.

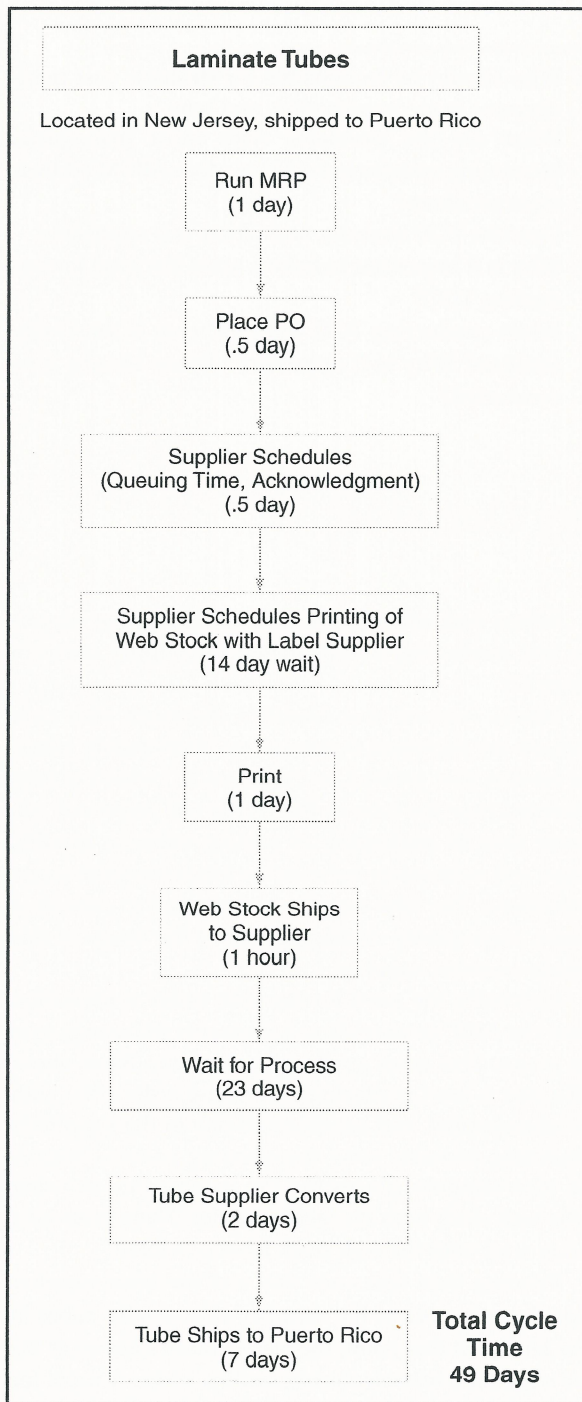


Figure 8.5 Process Flowchart—49 Days

There, the tubes are filled in a cosmetic manufacturing process, packaged into individual boxes, put into a case, and then shipped out for consumption around the world. However, the continental United States is the largest market for these products.

Selena contacted the tube supplier to get a better understanding of the waiting time. The manufacturer explained, "It's waiting time, just like when you want to go on a ride at Disneyland. Other people got there first."

Selena asked, "Shouldn't we go into the queue when our initial order arrives, rather than when the web stock arrives? After all, you place the web stock order, so you know it is coming."

"No can do. We don't schedule anything until we have all the materials. We are pretty much at capacity, and can't afford any delays or last minute rescheduling when something doesn't show up," the manufacturer explained.

Selena offered an alternative: "Well at Disneyland, you can pay extra to reserve a place in line, or move up in line. They let you schedule in advance now, if you are willing to pay. Would you consider that?"

The manufacturer sighed. "I see where you are coming from. We just don't do business that way. We have to turn customers away due to high demand because of our world-class technology. I'm sorry I can't help you out here."

Selena understood it was not going to be as simple as working with the current suppliers to fix the apparently easy issues in the processes. She was going to have to come up with a creative idea. Yet it had to be an idea that honored marketing's high-end image for the product.

CASE QUESTIONS

1. From a strategic cost management perspective, what are the cost and value drivers in this supply chain?
2. Which costs and associated processes do not add value commensurate with cost, and which should be considered for improvement?
3. Develop some ideas for improving the supply chain of this product, and redraw the process map based on those ideas. How long is the lead time now?
4. Is this project a good opportunity for total cost of ownership analysis? Explain why or why not, including what sort of costs you would try to capture if you do a TCO analysis?
5. Which assumptions and costs related to this process do you think you should perform a sensitivity analysis on, and why?