



The best companies differ substantially from the average!

- ★ The best give greater focus to the denominator of the unit cost equation -- apply best practice to assure maximum capacity *without* incremental capital investment; and their **costs come down as a consequence**
- ★ The typical company gives greater focus to cost cutting, without changing the basic processes that cause high costs; this has a low probability for success
- ★ The best are innovative at the shop floor level in assuring best practice and lower cost of production
- ★ The best use these higher margins (generated through lower cost) to “invest” in innovation for new product and process development, marketing, exploration, etc.



Does Cost-Cutting Work? Perhaps, BUT:

Several studies reached similar results. For example:

- ✦ In a study of 3,628 companies over a 15 year period, Morris, Cascio and Young reported:
- ✦ “Employment downsizers do not improve financial performance”:
 - “...those with the largest layoffs exhibited the largest decreases in ROA.”
 - “One striking aspect of downsizing is that the impact on profitability is negligible relative to the magnitude of the layoffs.”
 - “...not only did they fail to increase their return on assets, but they experienced a continued decline on their return.”



Cost Cutting (cont.)

Hamel reported on the concept of “Corporate Liposuction”- earnings growth rate is >5 times sales growth rate (using cost-cutting or constraints)

- In a review of 50 companies engaged in a cost cutting “strategy”, 43 suffered a significant downturn in earnings after 3 years
- Growing profits only through cost cutting is not sustainable, and must be balanced with sales growth through innovation, new product development, process improvement, etc.

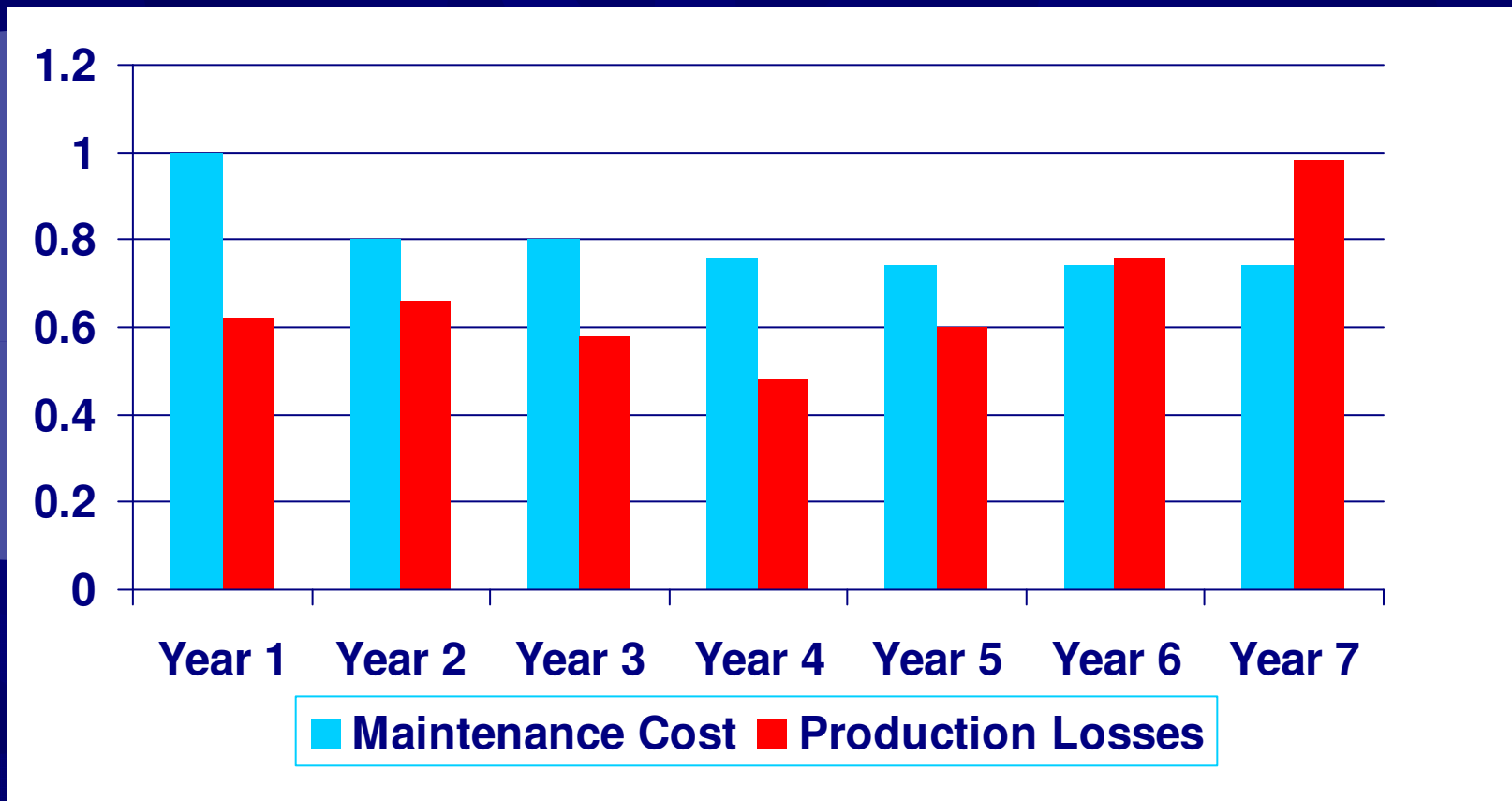
Source: Gary Hamel, Business Week, July 17, 2000



Cost Cutting (cont.)

- ✦ From these and other studies, cost cutting is a poor bet for prosperity. When does it work?
 - If you're a "C", and have no choice to survive
 - If you're a bloated bureaucracy, and must
 - If you're faced with reluctance in employees, unions, etc.; and/or need to get people's attention
 - In specifically targeted situations- obvious waste
 - In a major market shift, disruption, or downturn, e.g., 10-20%
- ✦ Much more likely to work when combined with restructuring of physical assets (Morris, et.al.)

Effect of Cost Cutting Strategy on Production Losses at One Business

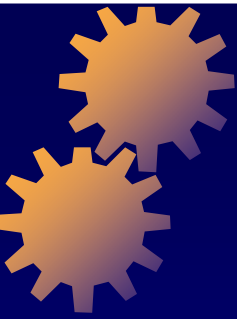


Source: Achieving Optimum Maintenance and Asset Strategy, David Ormandy, IIR Conference, Sept, 97, London, England



Cost Cutting (cont.)

- ★ Suppose our efforts to improve succeed, how do we manage the need for fewer people?
 - Attrition: don't replace those who leave through retirement, resignations, terminations
 - Reduced contract labor (be loyal to our employees)
 - Reduced overtime
 - Voluntary reduction; conversion to part-time labor
 - Re-assignment to process improvement efforts
 - Expanded business volume, with the same number of employees; and assignment to new jobs!
- ★ Many of these require ***flexibility***, and ***training!***



Cost Cutting - maintenance, a favorite target, but... (cont.)

“Maintenance’s contribution to Uptime is worth 10 times the potential for cost reduction.”

“As a result of our global benchmarking efforts, we have shifted our focus from cost to equipment reliability and Uptime.”

“Through our push for Uptime, we want to increase our capital productivity 10%... We value this improvement (at) US\$ 4.0 billion in capital projects (not required)...”

Vince Flynn, DuPont
Corporate Maintenance Leadership Team



Cost Cutting (Cont.)

**“You just can’t cost cut
your way to prosperity!”**

Vince Flynn, DuPont

Corporate Maintenance Leadership Team



Cost Management is not the same as cost cutting

- ✦ Costs are a consequence of your practices and processes –
Your systems design
- ✦ Cost management focuses on improving those, so that costs come down
- ✦ Cost cutting is typically not sustainable, but may be necessary in some situations



Asset Utilization/OEE

What do we do? **Begin** by measuring all losses from ideal- Asset Utilization (AU) or Overall Equipment Effectiveness (OEE) - If you could run your plant 8,760 hours per year, making 100% first-pass, first-quality product, at 100% of your maximum demonstrated, sustainable rate, with no losses for changeovers:

How much could you make?

How much are you making?

Where are your losses from ideal?

Most importantly,

Are these losses acceptable to the business?



How do we achieve Reliability and Manufacturing Excellence?

Not by relentless cost cutting
rather

By the relentless pursuit of best practices,
which assure reliability, so that costs are
NOT incurred- ***cost reduction is essential***

A common strategy with common goals will
yield organizational alignment, and superior
business performance



We must assure that we:

Design for lowest life cycle cost

Buy for total cost of ownership

Store equipment to retain its reliability

Install/Startup with discipline and precision

Operate with care and within process limits

Maintain the plant with precision for reliability

It's not Rocket Science !! It comes from establishing a culture that does the right things, at the right time, all the time.

Remember – Cost Cutting Alone Likely Results in Poorer Performance

