Incentive Use For Cost Reduction

Douglas L. Clausen, C.P.M., CPIM
Vice President Purchasing
ICON Health and Fitness Inc.
(435) 750-5000; dclausen@iconfitness.com

Abstract. We all know that many firms are now expecting the purchasing function to enhance the bottom line. We should all see this as a very beneficial move for supply management. To be successful, supply chain management will have to employ many strategic and tactical tools. One such tool may be the use of monetary incentives.

In this discussion, we will talk about incentives as a resource. This workshop will get participants to talk about why incentives may be a good idea. For example, "It could act as an offset to the predisposition to use a known source."

One case study and one example will be presented. The discussion will center around how incentives can drive cost reductions and how good projects can be road blocked (and why). Ideas relative to the use of incentives to prevent road blocking will also be presented.

Background. In recent years the supply management function has come more into the limelight. The management of most firms is demanding a tangible contribution from purchasing.

In many respects this is what has happened on the sales side of the business forever. Sales management is given sales growth targets and their success/failure is accordingly measured. Sales management in turn has to develop a strategy and motivate to accomplish the goal. Of course, one of the tactical methods is incentive based compensation packages.

Now that supply management is in this arena, it stands to reason that incentives would be an appropriate motivator.

A discussion about risk. A case could be made that a firm has a predisposition to rest. If everything is going well, the view on risk can be skewed. As we all know, current economic conditions though have forced a review of opportunities to reduce cost. This is what brings performance pressure on supply chain management professionals. This pressure, although necessary for survival or growth of the firm, will bring it off a rest position and expose it to more risk.

Examples are:

- New suppliers and/or international sources. Can they deliver a consistent product/service? Did the old supplier do things or adjust to situations that have never been documented? Are more complex logistics involved?
- Changes in processes. Will a plastic part really replace a metal part over the long haul?
- Lean Manufacturing. Will a snowstorm shut you down?

This may be a new world for many buyers/purchasing agents. Arguably, training and on the job experiences will be required. But again, this may mirror what has gone on in sales for years.

The buyers/purchasing agents will then enter into a higher risk mode as they push to lower costs. Many will see this as an exposure to mistakes, criticism etc. Because they are more familiar with a firm (or purchasing department) at rest, they will be reluctant to take the necessary steps (risk).

Application. So incentives will drive quality supply chain employees to step out. Didn't incentives do this for salesmen?

In the workshop we will spend time discussing incentives as a motivator. Incentives can take away the question, "What's in it for me?" We will discuss (somewhat through an example) the work involved in a higher risk environment and how incentives may be the motivator that drives the work forward. This would be especially true as problems are encountered. Incentives can be the path to more involved/responsible employees as their work relates to the firm's goals.

The next step, the problem, the solution. Back to the firm trying to change/respond/move forward. The purchasing group has been properly motivated to seek reductions and implement them. The appropriate people are up to speed on risks and the new landscape.

But, are the correct people really involved? As new suppliers, processes, and ideas come into the picture, I think other disciplines (within the firm) will resist and road block the change. Same reason, the risk is high for them, they have to come off a position of rest and more work will be involved with no additional return.

For example, a new supplier may make some initial quality mistakes. Now the QC function might say let's go back to the old supplier rather than train the new supplier.

The same motivation principles apply to them.

The workshop will bring out the idea that incentives have to go to all parts of the organization as they are involved in the projects. Other good ideas/projects may be thrawarted or delayed (because other parts of the firm do not want to take the risk.

Summary. We want management people to understand they have created a new world as purchasing/supply try to impact the bottom line. Incentives for both that group and others in the firm can help insure an appropriate balance between risk and results. They can motivate and prevent road blocking.