Kurt Salmon

RETAIL INDUSTRY INSIGHTS

Creatively Cutting Product Cost

Leading retailers will innovate, consolidate and collaborate to cut costs and build a solid foundation for future savings.

Reluctant consumers and rising input costs are prompting retailers to look for ways to save money by trimming the cost of their products. A three-pronged approach to product cost optimization will help ensure maximum savings without compromising value. Leading retailers will innovate, consolidate and collaborate to cut costs and build a solid foundation for future savings.

Innovate

Many retailers are pursuing lower-cost alternatives to classic materials, but with consumers still reluctant to spend, innovative materials must still deliver value. Whether the new materials wick better, last longer or feel softer, customers cannot perceive them as a cheaper alternative to the company's historical offerings.

It's essential to consider using innovative materials early in the product development process, as high raw materials prices force retailers and suppliers to turn to alternative materials to bring costs down. For example, HanesBrands is developing a flax fiber to blend into its traditionally 100% cotton garments.

After deciding which materials to use, ensuring they are used effectively can produce additional savings. For example, improving fabric yields can reduce the cost of a $195 pair of men's wool dress slacks by 50 cents a pair—a major savings over hundreds of thousands of pairs. The effect can be even more powerful on a less expensive garment. Eliminating a coin pocket from a pair of $29.50 khakis can reduce the cost by a nickel. But it's important to cut costs responsibly. Leading organizations are developing processes to help them identify when and where they can reduce the cost of a product without sacrificing its integrity.

Consolidate

Even if using innovative new materials—or less of them—isn't an option, improved materials management can still reduce costs. Take canned goods. Instead of having a factory procure the necessary steel and aluminum, consolidating purchases internally and working with the supplier to purchase these metals directly can result in increased purchasing power and significant savings.

To effectively consolidate purchases, companies need the right processes and systems. Even some of the largest big box retailers are gathering and analyzing data to determine how much of each material they purchase and how much they pay for it, across products and categories. From there, leading retailers use that data to drive strategy and develop processes to consolidate purchases of similar materials. A product lifecycle management (PLM) system and dedicated materials department help make this process even easier.

Consolidation also comes into the picture later in the product development process, when leading retailers are becoming increasingly focused, designing and sampling far fewer styles. Setting ambitious target development ratios will allow retailers to reduce the number of items being sampled, which can reduce costs significantly while still enabling retailers to develop a compelling assortment. One winning strategy is assigning development ratios based on the fashion pyramid. For example, fashion items will need the most samples, and as such, have a 3:1 ratio; seasonal basics are more predictable and therefore may have a 2:1 ratio; and basics live across multiple seasons and are a known entity, so only a 1:1 ratio is needed.

Collaborate

Finally, improved communication with vendors and mills can help reduce overhead and materials costs.

Leading retailers have developed strong relationships with mills and vendors, allowing them to reserve capacity and production space ahead of time and lock in the best materials prices by buying opportunistically.

Many retailers are also moving approval processes overseas so they are closer to factories. This can shorten cycle times and increase collaboration. Co-developing items that require a unique skill set—like footwear, handbags and swimwear—with suppliers can help retailers offer a wider breadth of products with less overhead cost and reduce the workload of already time-strapped development teams that may have suffered cutbacks during the recession. For example, leading footwear companies are building development centers near factories to realize these savings.

While most retailers are looking to trim expenditures, many have yet to take a holistic approach. Focusing on innovation, consolidation and collaboration throughout the product development process will help ensure costs are cut effectively and responsibly.

CASE STUDY

Client: A multibillion-dollar footwear wholesaler was faced with rising leather costs.

Challenge: Without a firm grasp on how much leather they used, the wholesaler had difficulty negotiating with suppliers for the lowest price.

Solution: Formalized data collection, analytic tools and increased collaboration across teams helped improve forecasting, while a team in China continually searches for cost-saving opportunities.

Result: The wholesaler is able to negotiate more effectively with suppliers to reduce the cost of its leather purchases.

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Kurt Salmon is the leading global management consulting firm specializing in the retail and consumer products industry. For more information, visit www.kurtsalmon.com.

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