



Pumping Up Profits for an Industrial Pump Manufacturer

A global sourcing strategy and smarter order processing reduces motor costs by 30%.



Business Profile

The client is a \$2 billion global manufacturer of industrial and engineered pumps and valves for the process manufacturing, water treatment, and utilities industries.

Business Challenge

The company's Vice President of Operations needed sizable cost reductions quickly, in response to competitive pressures on pricing and operating margins. The company hired Tenzing to evaluate all direct material spend, identify categories with the greatest potential for cost reduction, then develop and execute new sourcing strategies.

Results

In the third week, Tenzing Consulting shared the results with the Global Procurement executive. Clear imperatives for the organizational transformation had emerged:

- 30% reduction in motor component pricing among qualified, high-quality suppliers
- Consolidation of supply base from nearly 20 to three preferred suppliers
- Ability to offer customers lower cost product to win incremental business

Because That's Where the Money Is...

When asked why he robbed banks, the infamous American bank robber Willy Sutton immediately answered "Because that's where the money is." Operational improvement is not about robbing banks, but knowing "where the money is" often leads to obvious cost reduction opportunities. Roughly 50% of the cost of any industrial pump is the motor that drives it. Motors constituted over 25% of total cost of goods sold, nearly \$100 million annually. Analyzing motor spend was therefore an obvious starting point, but the motor commodity team was skeptical that any additional savings could be achieved.

Motor purchases are highly strategic and had received a lot of attention over the years from other cost reduction initiatives. Every year, the company conducted intensive high-level negotiations with all the major industrial motor manufacturers to ensure that pricing was competitive. As a \$2 billion company, the pump manufacturer did not believe they had much negotiating leverage with motors manufacturers the size of GE. Besides, the pump manufacturer's customers frequently selected the brand of motor they wanted on their pumps. That left little opportunity to consolidate suppliers or direct the spend to lower-cost motor manufacturers.

Insights from the Outside In

If the motor team's assumptions were correct, the opportunity for additional cost reductions on motors was limited. But were these assumptions correct? The \$100 million of annual motor purchases represented over 1% of global industrial motor demand—a fact that was unknown to the motor team. Having 1% of the global market demand gave them the potential for enormous bargaining power, if they could channel their purchases to fewer suppliers.

The conventional wisdom held that 90% of the time customers were specifying a motor brand at the time of a pump purchase, thereby preventing the pump manufacturer from concentrating spend among a few preferred motor suppliers. Just ask the buyers who process motor purchase orders—the name of the motor manufacturer was almost always specified. But, who put that information on the purchase order? The team's investigation found that the sales and order processing people were frequently designating motor brands. Sometimes they chose the brand randomly, and sometimes the customer exhibited a weak preference for a brand. In the end, it turned out that the customer required certain motor brands only 10% of the time—the opposite of the conventional wisdom. The team's fact-finding showed that a leverage-based consolidation strategy was a distinct possibility for cost reduction.

Not only could the pump manufacturer control the selection of the motor brand, but their customers stated that if offered lower-priced, certified motors, it would positively affect their purchase decisions because the price of motors was a dominant factor in awarding pump business. The emerging sourcing strategy therefore had the potential to help the pump manufacturer win even more business—growing the top line and the bottom line simultaneously.

Going to Market (with Confidence)

After educating sales, customer service, and purchasing on the new strategy and modifying the ordering system to enable greater motor selection control, the motor supply market could be engaged with more confidence and a more attractive volume profile. The volume profile now represented opportunities for a few qualified suppliers to each win tens of millions in committed business versus the existing no-commit rebate-based contracts.

The motor team, in collaboration with engineering and end users, assembled hundreds of detailed motor specifications and segmented them to correspond to the relative strengths and capabilities inherent to the motor market. The excitement among the motor suppliers was unprecedented and immediate. Based on a comprehensive request for quote, the motors supplier participated in a day-long online auction which resulted in motor prices dropping by 30% from the previously negotiated levels.

It was clear from the results that the few most technically qualified and cost-competitive suppliers would win the lion's share of the pump manufacturer's business. Implementation of the results required migrating worldwide demand across many sites to the newly awarded suppliers. The team tackled the implementation immediately, and completed the majority of the changes within six months. Needless to say, the bottom-line impact was enormous—"pumping up" profits by over \$10 million the following year.