SOURCING HIGH-QUALITY PRODUCTS WITH HARD BUDGET CONSTRAINTS.

TARGET COSTING
During a time of tight budgets, our client’s indirect Procurement team was tasked to source a technically complex production line for one of their factories. To this end, a cross-functional team had already developed detailed product specifications to ensure the production line met all functional and qualitative requirements our client would need. However, the Procurement team quickly realised that their conventional approach of asking suppliers to submit offers adhering to all specifications would lead to offers vastly exceeding their available budget.

Faced with the challenge of balancing tough budget constraints with maintaining high production and quality standards, our client turned to TWS Partners to define a sourcing strategy that would guarantee two things:

1. Nominate a supplier able to build a functional production line that fulfills the client’s high-quality production standards.

2. Stay within the budget.
THE TWS APPROACH

Combining our expertise in designing Game-Theory based negotiation processes with our experiences in creating incentive schemes to motivate suppliers to share their know-how, our consulting team developed a new sourcing approach: “Target Costing”. In a nutshell, Target Costing uses competition between suppliers to optimise the technical concept under a fixed target price. In a Target Costing approach, technical specifications and requirements are limited to necessary minimum requirements to give suppliers a high degree of freedom in developing their own concept within the pre-defined budget. Ultimately, our client gave all suppliers the commitment that the supplier to offer the best concept while meeting the target price would be awarded the business.
A TARGET COSTING PROJECT IS CONDUCTED IN FIVE STEPS:

1. **Setting the target price**
   The first step in a Target Costing project is to determine the target price for the awarded product. This target price needs to realistically reflect the product requirements while respecting the client’s budget constraints.

2. **Determining minimum requirements**
   The key to meeting the target price is limiting the technical specifications and requirements suppliers need to adhere to. By specifying only a few essential requirements (i.e., minimum requirements), suppliers are granted the creative freedom they need to develop cost-effective solutions. This allows our client to benefit from the (technical) know-how existing in the market, and take advantage of suppliers’ strengths and cost-innovative potential. However, limiting the technical specifications to a few minimum requirements is also the main challenge of any Target Costing project. The trade-off between granting suppliers the creative freedom to develop cost-effective solutions, and specifying enough technical requirements to ensure the functionality and quality of the product, needs to be carefully balanced. To this end, we conducted intensive workshops with all relevant cross-functions to align the final minimum requirements.

3. **Defining an evaluation framework**
   A tender that only dictates a target price as well as minimum requirements for the final product will naturally lead to very heterogeneous offers and concept submissions. To compare offers and concepts, we develop an evaluation framework where we pre-define evaluation criteria together with all relevant cross-functions. All submitted concepts are evaluated and assessed based on these criteria.

4. **Developing competitive concepts**
   During the actual tender, suppliers compete to develop the best concept while meeting the target price. Hereby, each participating supplier has regular technical discussions with our client and receives feedback to optimise their concept. Throughout these feedback sessions, concepts are steadily improved, resulting in viable concepts fulfilling all quality and production standards.

5. **Selecting the winning supplier**
   In the final step of a Target Costing project, all submitted concepts are evaluated according to the evaluation framework, defined in Step 3, to determine the best concept. Ultimately, the supplier who submits the best concept while fulfilling all minimum requirements and meeting the target price is declared the winner and will be awarded the project.
By implementing the Target Costing approach, our client successfully sourced a highly innovative and state-of-the-art production line while staying within the initial budget. The awarding project showed that tight budgets and sourcing high-quality products are not mutually exclusive. Avoiding technical overspecifications and granting suppliers creative freedom is key to fostering a healthy competition between suppliers to propose innovative and cost-effective solutions. The approach encouraged knowledge exchange between suppliers and our client, and allowed our client to benefit from the technological know-how existing in the market. As an added bonus, Target Costing presents an opportunity to expand the supplier set and increase competition as the approach may motivate suppliers, who were previously discouraged by the technical (over-)specifications, to participate in the tender.
TAKE COMMAND OF YOUR BUSINESS GAME.

CHANGE THE GAME AND MAKE THE RIGHT MOVES USING GAME THEORY TO WIN MORE OFTEN.