CASE STUDY

**A major cost reduction program at a supermarket chain**

**The situation**

A large supermarket chain found itself losing market share. It was suffering from long-term underinvestment in infrastructure and innovation. A critical factor was its over-inflated cost base, estimated to be several hundreds of millions of dollars larger than that of similar competitors. Central to this cost base was the prices they paid for the goods, mainly food, which were sold in their stores.

The buying teams within the business had become too remote from their suppliers. They negotiated the price of finished goods delivered to their warehouses without much insight into the underlying cost drivers. This meant that decisions they made about products, packaging, transportation and storage of goods often led to price inflation and growth in the cost base. Suppliers were reluctant to contradict such decisions, as they feared losing business. Buyers therefore got into the habit of dictating terms. Prices were often inflated surreptitiously. For instance, a supplier would use foreign exchange fluctuation as an excuse to increase prices or wait for a buyer to move jobs (which was a regular occurrence) and then take advantage of the new buyer’s lack of information and experience.

**The solution**

After some initial analysis indicated the scale of the opportunity to shrink the cost base, an external consulting team was invited by the Buying Director to get to work on reducing the price of goods. They recruited a number of buyers and other supermarket employees to work alongside them in a joint effort. The backbone of the approach they pursued was to break down end-to-end supply-chain costs into their component parts to identify where cost could be taken out. For instance, the cost of a box of tomatoes might be made up of the cost of growing and harvesting the tomato plants, the cost of washing and packing the tomatoes, the cost of the packaging and labels, the cost of transport and storage and, finally, the cost of taking the box from the storage area in a store and placing it on the shelf. It is likely that at least one of these cost components could be significantly reduced.

**Difficulties encountered**

The project began steadily taking cost out of several products, for instance by changing packaging specification or simply calling suppliers to account on inflated prices. Savings measured in millions of pounds were achieved in a matter of months, but this was far off from the hundreds of millions of dollars that had been targeted.

The project was an uphill battle. The biggest barriers were internal to the company and stemmed from uncertainty, mistrust and a feeling that change was being imposed from the outside. The cost-reduction team were seen as outsiders despite the fact that the most of the team members were supermarket employees. There was a feeling that they could not be trusted not to upset supplier relationships or that they would focus too much on cost and not enough on quality. There was also resentment that they had the time and money to focus on improvement while the buyers still had their day job to do. As a result, the cost-saving team did not get the support it needed. People resisted passively by being slow to help or through a variety of delaying tactics, and a few were openly hostile.

**The breakthrough**

In its first year of operation, the cost-reduction team became able to work effectively with the buying departments and with suppliers, and cost savings continued to rise steadily, but despite their best efforts, the pace of delivery increased only slowly.

The breakthrough came when the Buying Directors took a decision to train all of their people in the techniques that the cost-reduction team had been employing. Over a period of a few months every buyer, merchandiser and new product developer went on a three-day training course in how to take cost out of the supply chain.

**The results**

Some buyers used what they learned on the training course to reduce the cost of the products that they were responsible for, but these individuals were in a small minority. Most were too busy with their day job to take the time to work through the cost-saving process. However, as the techniques were now familiar to them, they realized that they made sense.

Trust between the buyers and the cost-reduction team increased as people felt more in control of the changes that were required to shrink the cost base. As a result, senior managers allowed the cost-reduction team into their departments. Likewise, the buyers provided support for their work or at least granted them access to work on their products and with their suppliers. Active and passive resistance largely fell away.

As for cost savings, the pace of delivery started to accelerate rapidly as the floodgates opened. In the first year of the program, savings were just under $40m. In year two, when the training took place, $120m was saved, and in year three $300m was saved (a total reduction in the annual cost base of $460m).

**Discussion questions**

1. Which stakeholders of the change initiative can you identify in the text?
2. Which strategies used the supermarket to win the internal resistance? Did they work and why according to you?