Lean Cost Management

...Taking the Waste Out

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US Coast Guard Academy

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Roadmap

- Defining Lean Cost Management
- Lean Up Front
- Lean Processes: Cost and Variation
- Visibility: Seeing is Believing….and Avoiding
- Final Thoughts
Defining Lean Cost Management
Defining Lean Cost Management

Lean Management Is......

A process for measuring, understanding, and improving the flow and interactions of all related tasks in order to keep the cost, service and quality of an organization’s products and services as competitive as possible.
Waste and the Flight of Value

Value-Creating Potential

Over-processing
Over-producing
Defects
Inventory
Transport
Motion
Waiting (Queue time)

The “Profit Bandits”
Defining Lean Cost Management

Lean Cost Management Is......

An approach to financial measurement that makes waste and the costs it creates visible, and hence actionable, wherever and whenever it occurs in an organization.
Defining Lean Cost Management

Effective lean cost management systems:

- Look like the processes they measure
- Emphasize what matters
- Are accurate, not precise
- Acknowledge…and reflect….desired behavioral results
- Integrate with other lean metrics
Lean Up Front

There are many ways we can affect costs before they occur.

preventing is easier than eliminating waste.
Lean Up Front

- Supply chain domain—Creating Partnerships
  - Working with suppliers to eliminate design features that increase cost and effort
  - Creating systems that eliminate transactions, automate re-ordering, minimize inventories, minimize re-design, and maximize the throughput of both your...and your vendor’s...processes.
Lean Up Front

- In the Customer Domain.....

Ensuring that the products and services delivered meet customer requirements—no more, no less.
# Lean Up Front: Cost vs. Value

**What do we do today?**

<table>
<thead>
<tr>
<th>Activities</th>
<th>% of Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Produce manuals</td>
<td>60%</td>
</tr>
<tr>
<td>Answer hotline</td>
<td>15%</td>
</tr>
<tr>
<td>Help locate repair/support services</td>
<td>10%</td>
</tr>
<tr>
<td>Revise manuals &amp; send updates</td>
<td>10%</td>
</tr>
<tr>
<td>Respond to letters</td>
<td>5%</td>
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</table>

**What does the customer value?**

<table>
<thead>
<tr>
<th>Activities</th>
<th>% of Customer Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hotline support</td>
<td>60%</td>
</tr>
<tr>
<td>Help locate repair/support services</td>
<td>20%</td>
</tr>
<tr>
<td>Respond to inquiries</td>
<td>10%</td>
</tr>
<tr>
<td>Updates and other services</td>
<td>5%</td>
</tr>
<tr>
<td>Manual availability</td>
<td>5%</td>
</tr>
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</table>
Customer-Driven Lean Cost Management

Value Stream Cost Profile

The “Untouchables”
- Future Value-Add
- Customer Value Add

Indirect Customer Support
- Business Value Add—Administrative

The “Profit Bandits”
- Non-value Add (Waste)

Value Creation Multipliers

Customer/Segment Preferences

Revenue by Attribute

Value Stream Value Proposition

Resources
Lean Up Front

At the Product Level...we turn to Target

Cost Management to maximize product performance while minimizing design and production waste.
Committed versus Incurred Product Costs

Customers’ willingness to pay

Less the

Desired Profit

Gives us the Target cost

Customer needs/wants/tastes

Competitive Analysis

Desired market share

Multiyear product profit plan

Organizational Goals

Company Capability

Final product features

The Basic Concept

Target Price $100.00
- Desired Profit 20.00
Allowable cost $80.00
- Current Cost 84.00
Target Cost $4.00
As we move to the Process domain, we begin to “look like” Lean Management....
Vertical Metric Alignment to Process/Enterprise Goals

Vertical Integration: Managing the Interdependence
US Coast Guard Academy

Process Classification Framework

Planning & Tactical Processes

1. Understand USCG Requirements and Expectations
2. Develop Vision and Strategy for the Academy
3. Design Programs and Pedagogical Materials
4. Develop Marketing and Recruiting Strategy

5. Identify, Recruit & Enroll Cadets

6. Deliver Academic Programs
7. Develop Military Knowledge
8. Develop and Ensure Cadet Wellness
9. Deliver Training Programs (LDC)

10. Graduate & Deploy Effective Officers

Management & Support Processes

11. Manage Personnel and Administration Activities
12. Information Resource Management
13. Manage Financial and Physical Resources
14. Manage Legal and Medical Support Functions
15. Manage Academic/Accreditation Records
16. Execute Community Services Programs
17. Manage Improvement and Change
<table>
<thead>
<tr>
<th>Process Code</th>
<th>Process Description</th>
<th>Total Process Cost</th>
<th>% Direct Cadet Benefit</th>
<th>% Indirect Cadet of Student Activities</th>
<th>% Future Academy Value-Add</th>
<th>% Acad Admin</th>
<th>% Non Value-Add</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Understand USCG Requirements &amp; Expectations</td>
<td>$389,474</td>
<td>$5,962</td>
<td>$45,686</td>
<td>$214,115</td>
<td>$96,651</td>
<td>$27,059</td>
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<tr>
<td>2</td>
<td>Develop Vision &amp; Strategy for the Academy</td>
<td>$813,652</td>
<td>$22,185</td>
<td>$28,515</td>
<td>$451,463</td>
<td>$194,834</td>
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<td>3</td>
<td>Design Programs and Training Materials</td>
<td>$2,014,872</td>
<td>$552,422</td>
<td>$214,176</td>
<td>$727,977</td>
<td>$431,289</td>
<td>$89,008</td>
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<tr>
<td>4</td>
<td>Develop Marketing/Recruiting Strategy</td>
<td>$488,642</td>
<td>$18,269</td>
<td>$22,026</td>
<td>$266,451</td>
<td>$114,625</td>
<td>$67,271</td>
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<tr>
<td>5</td>
<td>Identify, Recruit &amp; Enroll Cadets</td>
<td>$2,151,132</td>
<td>$600,453</td>
<td>$108,261</td>
<td>$922,490</td>
<td>$418,757</td>
<td>$101,169</td>
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<td>6</td>
<td>Deliver Academic Programs</td>
<td>$10,866,769</td>
<td>$7,041,154</td>
<td>$1,377,721</td>
<td>$1,686,168</td>
<td>$548,099</td>
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<td>7</td>
<td>Develop Military Knowledge &amp; Preparedness</td>
<td>$1,948,208</td>
<td>$1,383,351</td>
<td>$188,788</td>
<td>$289,193</td>
<td>$74,063</td>
<td>$12,813</td>
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<tr>
<td>8</td>
<td>Develop &amp; Ensure Cadet Wellness</td>
<td>$6,279,520</td>
<td>$5,180,351</td>
<td>$646,221</td>
<td>$176,381</td>
<td>$268,348</td>
<td>$8,218</td>
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<td>9</td>
<td>Deliver Training Programs (LDC)</td>
<td>$511,201</td>
<td>$278,938</td>
<td>$45,634</td>
<td>$118,061</td>
<td>$61,788</td>
<td>$6,780</td>
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<td>10</td>
<td>Graduate &amp; Deploy Effective Officers</td>
<td>$792,767</td>
<td>$323,427</td>
<td>$71,508</td>
<td>$89,877</td>
<td>$245,183</td>
<td>$62,772</td>
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<td>11</td>
<td>Develop &amp; Manage Human Resources</td>
<td>$2,939,062</td>
<td>$131,324</td>
<td>$834,703</td>
<td>$393,367</td>
<td>$1,268,007</td>
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<td>12</td>
<td>Manage Information</td>
<td>$1,398,218</td>
<td>$180,739</td>
<td>$303,269</td>
<td>$252,578</td>
<td>$523,673</td>
<td>$137,960</td>
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<td>13</td>
<td>Manage Financial and Physical Resources</td>
<td>$11,944,076</td>
<td>$4,609,590</td>
<td>$3,707,617</td>
<td>$1,095,870</td>
<td>$2,042,805</td>
<td>$488,194</td>
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<tr>
<td>14</td>
<td>Manage Legal, Military &amp; Academic Records &amp; Relationships</td>
<td>$3,954,311</td>
<td>$220,532</td>
<td>$776,733</td>
<td>$1,018,777</td>
<td>$1,484,667</td>
<td>$453,602</td>
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<tr>
<td>15</td>
<td>Execute Outreach/Public Relations Programs</td>
<td>$1,925,734</td>
<td>$590,984</td>
<td>$501,197</td>
<td>$397,245</td>
<td>$273,998</td>
<td>$162,310</td>
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<tr>
<td>16</td>
<td>Manage Improvement &amp; Change</td>
<td>$774,804</td>
<td>$180,745</td>
<td>$127,813</td>
<td>$373,986</td>
<td>$28,590</td>
<td>$63,669</td>
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<td><strong>TOTALS</strong></td>
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<td><strong>$49,192,441</strong></td>
<td><strong>$21,320,427</strong></td>
<td><strong>$8,999,868</strong></td>
<td><strong>$8,473,998</strong></td>
<td><strong>$8,075,379</strong></td>
<td><strong>$2,322,768</strong></td>
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100.00% 43.3% 18.3% 17.2% 16.4% 4.7%
Lean Up Front

Processes are made up of activities and resources. We build lean processes by understanding the activities that comprise them.
## Lean Up Front—Activities

### 2. Activity-Value Assignment

<table>
<thead>
<tr>
<th>CC</th>
<th>Process Code</th>
<th>Activity Description</th>
<th>% Direct Student Benefit</th>
<th>% Indirect Support of Student Activities</th>
<th>% Future Academy Value-Add</th>
<th>% Acad Admin</th>
<th>% Non Value-Add</th>
<th>Total (Must equal 100%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>gp</td>
<td>14</td>
<td>Generate transcripts</td>
<td></td>
<td>80%</td>
<td></td>
<td>10%</td>
<td>10%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>3</td>
<td>Build master schedule</td>
<td>60%</td>
<td>20%</td>
<td></td>
<td>10%</td>
<td>10%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>12</td>
<td>Decision support--CGA</td>
<td></td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>11</td>
<td>Manage/Evaluate personnel</td>
<td></td>
<td></td>
<td></td>
<td>80%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>12</td>
<td>Register students</td>
<td>60%</td>
<td>20%</td>
<td></td>
<td>10%</td>
<td>10%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>12</td>
<td>Produce cadet schedules</td>
<td>60%</td>
<td>20%</td>
<td></td>
<td>10%</td>
<td>10%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>12</td>
<td>Add/drop activities/adjustments</td>
<td>60%</td>
<td>20%</td>
<td></td>
<td>10%</td>
<td>10%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>6</td>
<td>Academic reviews</td>
<td>40%</td>
<td>0%</td>
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<td>30%</td>
<td>30%</td>
<td>100%</td>
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<tr>
<td>gp</td>
<td>12</td>
<td>Degree audits</td>
<td></td>
<td></td>
<td></td>
<td>60%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>12</td>
<td>Registration audits</td>
<td></td>
<td></td>
<td></td>
<td>60%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>15</td>
<td>Field inquiries from depts, students, etc.</td>
<td></td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>14</td>
<td>Filing &amp; recordkeeping</td>
<td></td>
<td></td>
<td></td>
<td>80%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>2</td>
<td>Manage information system development</td>
<td></td>
<td></td>
<td></td>
<td>80%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>11</td>
<td>Professional development</td>
<td></td>
<td></td>
<td></td>
<td>80%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>3</td>
<td>Product course catalog--maintain</td>
<td>60%</td>
<td>20%</td>
<td></td>
<td>10%</td>
<td>10%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>14</td>
<td>Meetings/Projects--Administrative</td>
<td></td>
<td></td>
<td></td>
<td>80%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>3</td>
<td>Meetings/Projects--Curricular</td>
<td>30%</td>
<td>30%</td>
<td></td>
<td>20%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>2</td>
<td>Planning meetings/committees/projects</td>
<td></td>
<td></td>
<td></td>
<td>60%</td>
<td>20%</td>
<td>100%</td>
</tr>
<tr>
<td>gp</td>
<td>0</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0%</td>
</tr>
<tr>
<td>gp</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0%</td>
</tr>
</tbody>
</table>

For each activity from step (1), please estimate the percentage of this effort that would be considered customer value-add (a customer would pay for it), business value-add (C, F or A), or non value-add.
Building Capacity: Resources vs. Systems

- **Resources**
  - Machines
  - Buildings
  - Computers
  - Taxes
  - Tooling
  - Software
  - Basic Utilities
  - People
  - Supplies
  - Materials
  - Tools
  - Dies
  - Productive Utilities
  - Purchased Services

- **Committed Capacity Costs**
  - Defined at Theoretical Limits

- **Managed Capacity Costs**
  - Defined at Currently Staffed Hours

- **Cost of Preparedness**

- **Classes of Capacity Costs and their Potential**

- **How This Capacity is Utilized**
  - Idle Capacity
  - Productive Capacity
  - Nonproductive Capacity

- **Competitive Cost**

- **Defined at the Process Level**

- **COST OF PREPAREDNESS**
Resources combine to make the process ready to produce.

But not all of these costs create value.
# Lean Up Front: Capacity

**Capacity Report**  
Southwest Airlines Example  
Year Ending: 12/31/2000  
(in millions of dollars)

<table>
<thead>
<tr>
<th>Summary Category</th>
<th>Category</th>
<th>Hours</th>
<th>% of total hrs</th>
<th>Cost Code</th>
<th>Cost Rate</th>
<th>Total Dollars</th>
<th>$’s Type of Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Idle Capacity</td>
<td>Off Limits</td>
<td>Airport/Flying Restrictions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Unavoidable Idle</td>
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<tr>
<td></td>
<td>Marketable</td>
<td>Unscheduled—Idle in Hangar</td>
<td></td>
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<td>Waste</td>
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<td></td>
<td>Total Idle Capacity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Productive Capacity</td>
<td>Standby</td>
<td>Repositioning Aircraft</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>BVA-??</td>
</tr>
<tr>
<td></td>
<td>Idle—Scheduling Gap</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Waste</td>
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<tr>
<td></td>
<td>Quality Issues—Delays not due to Eq.</td>
<td>Crew Shortages—Scheduling Problems</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Waste</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Crew Shortages—Lbr/Mgt Problems</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Waste</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Repositioning aircraft—schedule prob.</td>
<td></td>
<td></td>
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<td>Waste</td>
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<td>Baggage handling delays</td>
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<td>Waste</td>
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<td></td>
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<td>Wait for connecting flights</td>
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<td>Unplanned Maintenance</td>
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<td>Scheduled Maintenance</td>
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<td>Non-Productive Capacity</td>
<td>Load Passengers</td>
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<td>Unload passengers</td>
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<td>Tarmac “Time”</td>
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<td>Load Factor Loss (Yield)</td>
<td>In Flight Time</td>
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<td>Take-Off</td>
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<td>BVA-Current</td>
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<td>Weather delays rerouting</td>
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<td>Airport delays—inground</td>
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<td>Productive Capacity</td>
<td>In Flight Time</td>
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<td></td>
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<td>Value-Add</td>
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<td></td>
<td>Take-off</td>
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<td></td>
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<td>Value-Add</td>
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<td>Landing</td>
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<td>Value-Add</td>
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<td></td>
<td>Total Productive</td>
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<tr>
<td></td>
<td>Total Capacity Hours + Costs</td>
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</tbody>
</table>

Number of planes within class

**Variances**  

**Standards**
Lean Processes:

Cost and Variation
This observation is outside the acceptable range. The process will need to be adjusted.
Variation and Process Performance

The Issue

\[0.99^{15} \times 0.95^4 \times 0.80^1 =\]

56% First Pass Yield!!
Variation and Process Performance

Customers get exponentially “angrier” as the length of the delay increases.

- 15 minutes; no impact
- 1 hour--1 in 8 pass. Will not fly with you on next flight.
- 5 hours or more: all passengers will not fly with you for 1 year or next flight, whichever longer.
Variation and Process Performance

Sequence of NSM’s

Connect in “time-space,” not geographic location.

Preferred “tail” and Crew routing

Low Cost “swap outs” of “tails” and crews

80% of trad’l load

10% of trad’l load

10% of Trad’l load “transfers”
Variation and Process Performance

But.....Long haul flights and an increase in transfer, or “thru” passengers, violate most of these assumptions!!

In violating the “55 minute” flight logic, SW can violate its “am-pm” crewing. This leads to issues either regarding overtime, required off time, etc.
Variation and Process Performance

- Variation....accumulates
- Variation....disrupts
- Variation....generates waste

Exponentially!
Visibility

Seeing is Believing…and Avoiding
Visibility

- What gets measured becomes “visible”
- What gets rewarded gets done
- Or….as is more commonly noted

*You get what you measure & reward*
Visibility

**Lean Process Metrics**

- Time: Process time, lead time, & value-added time
- Changeover time
- Typical batch sizes or practices
- Demand rate
- Percent complete & accurate
Visibility

Lean Process Metrics

- Reliability
- Number of people
- Inventory
- Information technology used.
- Available time
Visibility

- These are the more “traditional” ways to think about measuring...and managing processes and performance.

- There are other options and other ways to make waste and performance visible.....
Pareto Analysis by Source

- Data Entry: 35%
- CCR Vendor: 25%
- Slow Response From External Party: 25%
- Out of Process Control: 15%

% of Errors: 40%
Visibility

PRODUCTIVITY

PREVENTION

LEVELS OF EFFORT

SUPPRESSION
An Accountant’s Perspective

Regardless of the performance improvement methods and tools that companies choose to apply, they should be aware that their enterprises are subject to certain natural properties....One commonly overlooked natural property...is that time, cost and quality are linked, not independent of one another.

Gary Cokins
Visibility

Performance Management—An Integrated View

Strategic Objectives
- Marketing Objectives
- Financial Objectives

Core Strategies
- Customer Satisfaction
- Flexibility
- Productivity

Critical Success Factors
- Quality
- Delivery
- Process time
- Cost

Key Performance Indicators
- Defects Per Million
- Scrap costs
- % on-time Delivery
- Frequency of Delivery
- Cycle Time
- Time to Market
- Conversion Cost per Unit
- Materials Costs per Unit

Operations Pipeline
Final Thoughts
Final Thoughts

- Financials are measures....that matter

- Financial measures are powerful....

- Fact: We are the Machiavelli’s of our organizations!
Final Thoughts

Lean Cost Management requires a blended set of tools

- Supply chain management to keep waste out of the system before resources arrive
- Customer value management—to make sure everything we do creates value, not waste
Final Thoughts

- **Target cost management** — to focus product development on cost avoidance, not elimination after-the-fact

- **Process management** — to find waste wherever it hides

- **Capacity cost analysis** to ensure optimal use of our physical assets and resources— to avoid building in waste that cannot be avoided downstream
Final Thoughts

Questions we need to keep in mind.....

- **Definitional:** What are we doing? Why?
- **Structural:** How do we achieve fit?
- **Physical:** What is the best cost model?
- **Cultural:** What impact on behavior?
- **Historical:** What has & hasn’t worked?
Final Thoughts

Lean Cost Management Is......

A Journey,
Not a Destination
It's All a Matter of Perspective.

To the optimist, the glass is half full; to the pessimist, the glass is half empty; to the management accountant, the glass is twice as big as it needs to be.

Anon