

Effects of cost reduction strategies



**ASSIGN
BUSTER**

1. Background of the study

The selected organization is a medium scale garment manufacturing factory located at suburb area of the country. Factory has capacity to provide employment opportunities for over 80 skilled labours. Since year 1995 factory is being manufacturing garments – Shirts, Trousers, Jackets, Blouses, Night wear, Babies garments etc for local and foreign market. In order to earn profits, the factory organizes the factors of production to produce garments that meet the demand of local and foreign market. To maintain the profitability of the organization it has become necessary to reduce the cost of the product and increase the quality of the garments.

For most purpose of this study is to practically preview cost reduction practice of organizations and effect of the practices in the organization. Cost reduction measures became most significant and prioritize topic in current business strategy due to the prevailing global economical crises. Cost reduction measures address questions about the efficient and effective management.

A comprehensive study of practice of cost reduction measures of garment factory and effect of the measures in factory was difficult because of data limitations and managers reluctance to provide data. Inadequacy of available data makes it difficult to state precisely practice of cost reduction measures and effect of that. This is further complicated by the fact that managers hide some information purposely by thinking this information will go to their competitors.

2. Cost Reduction Techniques

Cost reduction strategies helped the organization to match its capabilities with opportunities in the market place to accomplish its objectives. To maintain the profitability of the organization and to get the competitive advantage, the management has introduced some cost reduction methods during last two years. Although indirect costs are relatively small percentage of total cost, management equally introduced cost reduction measures for both direct and indirect cost sources. Revealed data proven that organization was able to save over seven millions of rupees during last year. The implemented cost reductions measures as follows,

List of cost reduction approaches implemented by the selected organization

- Production process redesigning
- Waste management
- Overtime work reduce
- Staff reduce
- Cut off of medical insurance facility
- Cut off of food facility
- Suspension loan and salary advance facility
- Reduce transportation facility
- Electricity saving measures
- Cost reduce through limiting Telephone facility
- Reduce office maintenance cost
- Stationary and documentation cost reduction
- Introduction of new production
- Product development

- Suspension of organization's annual trip
- Time saving measures
- Cost reduces through inventory controlling.

3. Categorization of cost reduction measures

1. Product process related cost reduction approaches

- Cost reduction by production process redesigning
- Cost reduction through waste management
- Cost reduces through inventory controlling.

2. Employee related cost reduction approaches

- Cost reduction by overtime work
- Cost reduce by Staff reduce
- Staff welfare cost reduction
- Cut off of medical insurance facility
- Suspension of interest free loan facility and salary advances
- Cut off of food
- Suspension of organization's annual trip
- Cut off of transport facility
- Time saving measures

3. Administration and office maintenance related cost reduction approaches

- Electricity saving measures
- Telephone
- Reduce office maintenance cost
- Stationary and documentation cost reduction

4. Customer related cost reduction approaches

- Introduction of new production

- Product development

4. Evaluation and Analysis of Cost Reduction Techniques

1 Product process related cost reduction approaches

1.1 Cost reduction by product process redesigning

To reduce cost, the organization had redesigned production process.

Sequentially to optimize the all manufacturing process, Manufacturing, sample testing, procurement handling, delivery service and repairer had been redesigned with the concern of best cost, quality, safety, customer satisfaction etc. Designers had been encouraged to watchfully specify part quality by taking into consideration the cumulative effect of part on product quality. Production time was saved by quickly assembling few parts with better quality. Parts are ease of production and commonality with other designs. This method support standardization of parts, minimum use of purchased parts, modular design and standard design features. It has reorganized the building to order and gathering customization. All parts keep available at all point of use, makes it easier for parts to be pulled into assembly which eliminate the unnecessary movements. By ordering less type of parts in large quantities it reduced material overhead cost. Organization was able to reduced cost and improves flexibility by redesigning.

According to the management, overtime payment amount at the same time as nearly 20% of salary during past few years. It shouldered around 5% of total direct cost. Organization was able to meet customer deadline without doing overtime works as a results of process redesigning. In order to redesign manufacturing process, organization had used expert process

development team and paid them amount at the same as 9.5% of annual overtime amount. By parts keep available at all point of use, and eliminating unnecessary movements, one store helper's duty had wipe out without any effecting. Organization was able to save amount at same time as 10.5% of salary and one store helper's salary valued Rs. 5,900/- by process redesigning. This redesigning of the process ensure that how well the features work and had significantly influence on quality, reliability and how quickly new product can be introduced into the market. Consequently cost benefit of the redesigning is much higher than the overtime saving and one labour salary.

1.2 Cost reduction through waste managing

Increase productivity by eliminating many types of waste. Such as excess inventory and unnecessary handling, time wasting, defects, reworking, material wastage. Waste materials had been sold to domestic producers at very low prices. Organization had started to produce new dresses by using west material especially for the local market instead of selling to the domestic. Theses product are providing at very cheap price and it is good opportunity for the customers. Organization was able to additionally earn at least fifty thousand per month. Because of this decision the domestic people loss their live hood.

In order to save time, introduced token system for workers to minimize away from work station (if any worker wants to go out of work station even to go to toilet or any other emergency they should get permission token from supervisor and when employee back to workstation he should immediately

return to the supervisor), and get rid of unnecessary process (Ex: reduced double stretch to one stitch in some products).

To prevent unnecessary interruption organization had introduced proactive equipment / machine maintenance method. On that organization had enter in to service agreement with third party organization which cost was around Rs. Hundred and fifty thousand per annum. With this agreement, servicing organization randomly come and does necessary service to all machines without interruption to normal process. As a result of no any machine take away from process during last year where which frequently experiences early. This decision accelerates production and optimized labour consumption. To ensure the optimum use of machine tool and workstation, one piece flow lines balanced to do the required tasks at each station. This may also help to meet deadlines without doing overtime and terminate the supervisory staff.

1. 3 Cost reduces through inventory controlling

Inventory controlling is another important cost reduction source. Materials comprise of the 60 to 70% of the total production cost. The various techniques have been introduced to controlling inventory handling cost. Organization had removed non moving stock because non moving stock goes on adding overheads for a period of years and it becomes a blocked inventory. Organization uses classification system. This helps to reduce stock handling cost and organization was able to reduce one store helper service. Cost benefits of these techniques are particularly high.

2. Employee related cost reduction approaches

2.1 Cost reduce by stopping overtime work

As it is explained by the Sri Lankan law overtime work is one and one-half times or doubles size payment. Though overtime is high cost source organization had used overtime works for provide high quality products to customers and meet their target. According to the management, overtime payment amount at the same time as nearly 20% of salary during past few years. It shouldered around 5% of total direct cost. The management has stopped over time work and payments. This decision is effected to factory and office employees. This factory had used to pay overtime payment for managerial staffs as well. Top Management has consecutively introduced flexible working hours for the management staffs to success in overtime payment suspension procedure.

The organization was able to save money as at least 20% of salary due to the overtime suspension decision. As per managers, no any order or job has been delayed due to this measure and they are getting same output as they got early by working overtime. Employees ware adherent to work overtime and receive additional payment. Consequently staffs misery and labour turnover is increased in the factory. Overtime work is more costly and it significantly effect to the organization's cost structure. In other hand, Humans cannot continually work long hour and their output gradually reduces as they are tired of working long hours. Therefore cost benefit of overtime work rather low. However, organization was able to save at least money same as 20% of monthly salary. As management there is no such a big deference of output comparatively overtime work period and non

overtime period. Organization was able to get maximum use of human resources during working hour. One reason for that may be by limited employees working hours to 8, employees may give their contribution without exhausted. Though hiring cost increased this is a good cost reduction method.

2. 2 Cost reduce by Staff reduce

It is observed that salary denoted nearly half of organization's cost. By redesigning production process and introducing production team concept, it was able to eliminate unnecessary job. Organization has terminated 5 labours, one office peon, two supervisors, one assistant manager and two clerk's service. Organization was able to save nearly hundred and fifty thousand per month by reducing employees. This decision was a considerable damage to the high job security which was experienced by the employees during last ten fifteen years. This decision adversely effect to the employees moral and face uncertainty.

Sri Lankan labour law is not a flexible law and it always facilitate the employee and it gives poor aid to employers. This organization falls to reduced staffs to protect many other employees and the organization. Terminated staffs have been paid one month salary additionally and gratuity. Some of terminated staffs have taken legal action against to the organization on their termination. Organization occurs to pay additional payments for legal officer. Though organization is able to save considerable saving on this measure, addition cost source was initiated as a result of. This situation was raised as a result of unorganized implementation. If prior approval was taken from legal authority this cost sources may not be occurred. Therefore

organization was unable to success in cost as expected due to wrong implementation. High job security enhanced staff loyalty and builds a healthy and happy working environment and promoted good relationship among the staff but with this decision employees experienced uncertainty. This may also a motive to increase labour turnover.

2. 3 Staff welfare cost reduction

Performances of the organization depend on employees' enthusiasm and satisfaction with their jobs; all affect the productivity, reputation and survival of the firm. Employees are the main driving force of the organization.

Organization believes that employees are their most valuable asset. To enhance staff loyalty and ensure they have an excellent working environment organization had provided verity of facilities for them. Few of them are medical insurance coverage, transport facility, pleasant working environment, Interest free staff loan facility, payment for residual leave, fifteen minis religious memorial period for every day, salary advance if necessary, annual trip and etc. All these facilities help to build a healthy and happy working environment and promoted good relationship among the staff. But organization was urged to cut off these facilities to be success in increasing market competition and global economical crises.

2. 3. 1 Cut off of medical insurance facility

All level employees experienced medical insurance facility. They were paid all their medical expense including hospitalization charges. Medical insurance coverage helps to increase employees' satisfaction and promote healthy relationship among employees and employer. Medical insurance coverage was gaining in popularity with staff grade employers and not that

much popular within labours. As Sri Lanka is a country which provides free medical service to its nations cut off of medical insurance coverage is not such a big issue for the labours. But that decision was badly affected to the managerial staff's enthusiasm. Organization was able to save over five hundred thousand rupees yearly on this decision. Organization was able to save considerable amount of money which less affected to labours and significant effect to staff grade motivation. However this is a comparatively good cost reduction method of a factory.

2. 3. 2 Suspension of interest free loan facility and salary advances

Organization had provided interest free loan for permanent employees which not more than employee's one year salary. Inference period is three year. Other than to the staff loan salary advance also suspended. Management has planned to invest company money in to business promotion. This decision helps to shield the business and it helps to increase stability of the organization. Suspension of staff loan facility is not considerable affect to the managerial staff as majority of the staffs had already taken loan and managerial staffs are more secure in economically than labours. But the suspension of salary advance is badly effect to labours enthusiasm and it may also act to increase labour turnover. Cost benefit of this technique is comparatively low. It is observed that organization was unable to save considerable saving on account of.

2. 3. 3 Cut off of food

Organization provided breakfast, lunch and tea to all level of employees. Majority of employees' are poor female. This meal facility helps to maintain

their body nutrition level and helped to increase enthusiasm. Some poor girls may come to work without meals and others may have to wake up early morning to prepare their meals as a result of cut off of food facility. Any employees can work on their maximum capacity if they're mentally and physically fit. Therefore cut off of food expenses can be adversely affected to the output. Organization was able to save at least one hundred and fifty thousand and other hand it may badly affect to the employees effort and moral. Organization experiences comparatively high level of absenteeism after implementing the decision. It can be identified as not good cost deduction method to factory which employed majority female low income employees.

2. 3. 4 Suspension of organization's annual trip

Employees are the most important resources of the factory. The annual trip is corporate team building exercises which helps individuals work better on individually and together. Getting to know each other is a great way for staff to form stronger working relationships. Staffs who are not usually working together have opportunity to bond and is good opportunity for new and shy members to get involved focused task. Further rewarding staff with a fun day out employees feel valued by the employer and more likely to be happy at working and loyal. Getting away from the everyday tasks can gives employees a fresh feeling. It helps to identify staff strength and weaknesses and it helps to provide right opportunities for staff back at the office for them to develop. Build relationship among co-workers. Additionally, staff themselves will learn more about theirs and others' strengths and weaknesses. Organization saved around hundred thousand yearly but the

saving benefit is comparatively low considering the benefit of this team building event.

2. 3. 5 Cut off of transport facility

The organization is a medium scale garment manufacturing factory located at suburb area. Public transportation facility of the area is in very poor level comparatively to the urban area of the country. Organization had provided office maintains vehicle for managerial staffs and separate vehicles to transport workers and office staff. There was a not implemented cost reduction measure for managerial staffs transport facility. Organization has employed two buses to transport all employees including staff and workers instead of two busses and van which employed early. Organization was able to reduce transportation cost by Rs. 40, 000/- per month by this decision.

2. 3. 5 Time saving measures

It was introduced token system for workers to minimize away from work station (if any worker wants to go out of work station even to go to toilet or any other emergency they should get permission token from supervisor and when employee back to workstation he should immediately return to the supervisor). This method more scientific and in long run this will effect to staff frustration. It was unable to save considerable saving. Cost benefit of the method is very low. It was advised staffs to warship or prays before working hour which was used to done by the staff after working hour early. By allowing memorize employees' to their religion before start the duty management expected to create peaceful and harmonious working environment. This may also directs to meet costumers target without

overtime work. This is good time saving method. By adjusting transport vehicle time accordingly, management was able to facilitate employees to continue this exercise. Organization was able to save 350 man hours monthly valid nearly twenty thousand without influencing to employees and devoid of harm their objective.

3. Administration and office maintenance related cost reduction approaches

3.1 Electricity saving measures

The use of air conditioners within office premises has been stopped and circular had issued to all staffs by advising electricity saving measures, on that staff have been advised how they can assist to save electricity while working. (Staff switches off computers and lights when they go outside of the work station). As this factory located at damp whether area this issue is not effected to the staffs productivity. Organization was able reduce electricity bill by at least five thousand per month without effect to the output.

3.2 Telephone

All telephones unites have been locked and introduced upper limit of monthly telephone charges and if it exceeded particular employee is responsible for the excess. There was no considerable deference between before and after introduced of the policy. As telephone facilities has provided to management staff and they all use that facility for the official mater. Whether limits are exceeded it all uses for the business requirements.

3.3 Reduce office maintenance cost

Office and factory cleaning service provider's service had stopped and assigned to office peons and helpers. Part time worker has recruited for

sanitary service by paying Rs. 2, 000 per month. Organization was able to save twenty thousand of rupees which they paid to cleaning service organization. Due to this decision labor turnover has increased. Organization was unable to the attained that they maintained early on cleaning and sanitary facility. This is not a good cost reduction measure to the organization.

3. 4 Stationary and documentation cost reduction

Organization started to use Low price stationeries and strong stationary controlling methods have been introduced. Organization was able to reduce around five hundred rupees per month from this measure.

4. Customer related cost reduction approaches

4. 1 Introduction of new production

Factory manufacturing garments – Shirts/Trousers/Jackets/Blouses /Night wear/Babies garments etc for local and foreign market. It is introduced low material and labour consumption garment to the local market. Organization has been involved in the development of garments for low-price. As revealed it is marketed low cost product with low price. This is a good opportunity for the customers. This is a good accomplishment for organization to win the customers.

4. 2 Product development

Organization had introduced new dresses by using west material especially for the local market instead of selling to the domestic. Theses product are providing at very cheap price and it is good opportunity for the customers. Organization was able to additionally earn at least fifty thousand per month. The organization always targeted to win the upper income level customers

and they had ignored lower income group by producing high quality high price garments. With this development organization was able to catch the low income group by producing high quality garments at cheap price.

Organization was able to expand the market rather than limited in to the high income customer group.

5. Conclusion

The long-term practicability of an organization's business plan depends on supporting its competitive advantage. Competitive advantage is usually attained through developing new products to improve quality and reduce costs. For most purpose of this study is to practically preview cost reduction practice of organizations and effect of the practices in the organization. The selected organization is a medium scale garment manufacturing factory located at out of metropolitan city. Cost reduction strategies helped the organization to match its capabilities with opportunities in the market place to accomplish its objectives. To maintain the profitability of the organization and to get the competitive advantage, the management has introduced some cost reduction methods during last two years. Although indirect costs are relatively small percentage of total cost, management equally introduced cost reduction measures for both direct and indirect cost sources. Revealed data proven that organization was able to save around one million of rupees during last year. The exercised cost reductions measures were, employee related, production process related, customer related and administration and office maintenance related cost reduction. It is observed that organization had implemented cost reduction techniques without doing proper cost benefit analysis. However revealed data proven that organization was able to

save over seven millions of rupees during last year. Reducing overtime work, Staff welfare cut off, Production improvement, Introduction of new production, Production process related, Productivity increasing measures, Wastage reduction measures, Electricity saving measures have been successively accomplished the organization goal while employee reducing, office maintenance measures ineffective.