

# LOW COST vs RIGHT COST



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With the increasing inflation rates and the worry that industrial growth may slow down, business houses are

under tremendous pressure to control their cost and live with NO or MINIMAL increase in their product prices. Increasing raw material cost and price sensitive market is further adding to this challenge. The first area for cost reduction that comes to any business manager's mind is logistics. It is assumed that logistics does not contribute to the product quality and hence any cost reduction measures undertaken in this area does not render product uncompetitive for quality reasons.

Once the pressure on cost reduction is mounted on the SCM/Logistics head of the organisation, it is expected that he gets "low cost at any cost." It is very critical in this perspective to understand the difference between 'Low Cost' versus 'Right Cost'. While low cost is always desirable, most often, it need not be the right cost. Overlooking this fact at times can lead to other complications including business disruptions. It is important that an organisation operates at Right Cost for its survival in long run. Following are the areas where usually Businesses fail in recognizing Low Cost as against Right Cost:

## Staff Cost

Usually the outsourcing of logistics operations are done with a belief that the staff cost will be lower as compared to that of in-house operation. Besides for expertise or focus reasons, it is also done to save on staff compensation, welfare, training and other facilities which otherwise organizations would have incurred on their own employees. Given the expectations on competency and service levels from the outsourced agency, this need not be completely true.

## Labour Cost

Minimum Wages Act is applicable all

over the country. Once the organization negotiates and finalises the labour complement and cost, rest is left to 3PL operators to manage. One should not be surprised, if he finds that the number of labour actually deployed are more than the agreed number. 3PL operators still manage this within the agreed costs (or even at lower costs sometimes) by compromising on statutory provisions. There are examples where underage labour is employed at costs well below minimum wages. It is not that organizations do not know about it, but they have very little choice, because compliance attracts cost. The cost of correction, in case of non-compliance is seldom thought of. It would be a huge cost and irrecoverable damage to the brand. And hence, the RIGHT COST would be the cost that ensures compliances.

## Employee Facilities

Most of the organizations provide free/subsidised meals, conveyance and other facilities to offer comfort to the employees to retain them. However, when it comes to outsourcing, these expenses are seen unwanted and hence qualify for cost reduction efforts. The Right Cost in this situation will be the minimum cost required to provide comfort to the staff of 3PL and ensure retention. Higher labour turn-over affects service levels and results in indirect cost to the organization.

## Warehouse Facility

Organization's in-house warehouses invariably have all basic facilities and equipment which ensure proper handling, storage and product damages. Proper flooring, docks, dust free areas, quarantines, pallets, stacking norms, racking and shelving, requisite material handling equipments, temperature control systems, fire fighting, pest control etc. are invariably in place and costs are earmarked to maintain the standards. However, the same cannot be said when it comes to 3PL warehouses. Most of the basic facilities and good warehousing practices are compromised as a cost reduction measure. This results in lowered human and product safety along with inefficiency and higher product damages.

## Warehouse Upkeep

One would find that the quality of in-house warehouse upkeep as compared to that of outsourced one is way different. In many cases, this could be attributed to cost saving measures. The approach should be the Right Cost in line with expected upkeep standards.

## Conclusion:

It is critical for organisations to consider logistics partner as their extended arm. The same amount of thrust and importance that is given to other functions should also be given to logistics and supply chain function. A good quality product gets maximum value when it is made available at RIGHT PLACE and at RIGHT TIME. It should also be at RIGHT COST, rather than at vitiated low cost.

## How can an organisation ensure that they operate at Right Cost?

- ▶ By providing required manpower based on demonstrated productivity and mutually agreed improvements.
- ▶ By paying wages and salaries as per Minimum Wages Act or industry standards (whichever is higher).
- ▶ By providing adequate employee welfare, training and other facilities.
- ▶ By providing adequate equipments and tools to execute the logistics responsibilities.
- ▶ By allowing reasonable returns to outsourced agency in line with the investments, competency and efforts.
- ▶ By making 3PL team a part of organizations reward and recognition initiatives.

## The above will ensure. . .

- ▶ Low employee turnover in the logistics function. Thus continuity with no impact on operations.
- ▶ Motivated employees with higher productivity and creativity.
- ▶ Capturing of correct cost of operations.
- ▶ 100% compliance will keep the Organisation and Brand, risk free.
- ▶ Availability of stocks – at right time, right place and RIGHT COST.
- ▶ In promoting "partnership" rather than "principal-agent" relationship. ▽