

Cost Modelling

A little trick that unlocks massive value

11th May 2021

There is a phrase often used in the commercial world – “80% of a negotiation is won before you enter the room”.

I agree with this.

It all comes down to preparation.

The question is, “what is the preparation that needs to be done?”

Preparation includes things like: clarifying your objectives, aligning stakeholders, researching the market, considering the moves the other party might make, and so forth.

But of all the preparation tasks, understanding the cost structure of the product or service you’re buying is likely to be the one that delivers you the best ROI for your time.

We need to understand what “it” (it being the product, material or service etc.) “should cost.”

Cost modelling is a fundamental procurement skill. It’s like a fishmonger being able to fillet a fish with precision. Or a pâtissier, making just the right consistency of pastry.

But for those of you who did lots of baking during lockdown, it’s not always easy!

It’s part art, part science.

Which is why many people find cost modelling hard to grasp.

Fear not!

Over the course of this year, I will break cost modelling down into several bitesize chunks.

Today, we’re going to see how drawing a simple picture forms the bedrock and architecture for your cost model.

That’s right – *drawing a picture*.

It sounds simple, but I’ve helped my clients generate 10s of millions of pounds/dollars/euros of value just from drawing pictures.

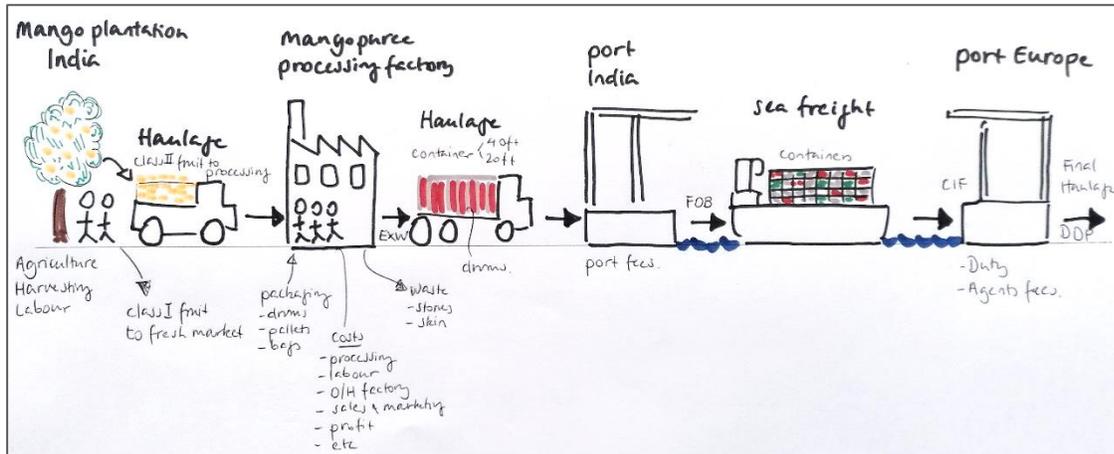
Consider something you’re sourcing now:

- Flour?
- Cardboard boxes?
- Coconut oil?
- Steel girders?

Map out the key elements of the supply chain from start to finish. Label the steps.

Don’t miss any activities – it’s easily done!

Here's a simple example from me to source mango puree:



The next task is to turn your picture into an excel table – we'll need some numbers at some point!

Most people seem to like drawing supply chains left to right. Typically, cost models are created vertically, so you'll need to transform your horizontal picture into a vertical excel table. To do this, rotate your picture clockwise through 90 degrees, starting with the first step of your supply chain at the top of your excel table and finishing with the last step of your supply chain at the bottom:

Cost Element	Cost (USD/T)
Raw Material (Mango)	tbc
Yield (%)	tbc
Mango Puree Equivalent	0
Processing	tbc
Overheads	tbc
Packaging	tbc
Profit	tbc
EXW Processor	0
Processor to port	tbc
Port Fees India	tbc
Shipping to Europe	tbc
CFR Europe	0
Port Fees Europe	tbc
Duty	tbc
Transport to final destination	tbc
Agent Fees	tbc
DDP Destination	0
Total	0

You've just created the architecture for your cost model.

Before my next newsletter in 2 weeks' time:

Ensure you've got your supply chain mapped out.

You have an excel table that looks something like this.

Fill in any of the pink cells you can.

There's a fair chance you won't know all the costs. We'll be covering "how to estimate" in the next newsletter, so we can get this sorted.

Also, have a think about what you want your cost model to do for you. What outputs do you want it to give you? What value do you want from it?

A robust forecast for your new budget?

Meaningful cost savings ideas?

A benchmark between supplier A and B, spec A and B or production country A or B?

Something else?

I'd love to see any of your supply chain mappings or excel tables. Do email them over.

For anyone who sends me their picture/excel table, I'm willing to give you a complimentary 15-minute session to discuss and refine the architecture of your model.

Simon

Frost, Procurement Adventurer