

Material Cost Reduction At Large Steel Castings Manufacturer: Material Purchasing And Usage Reductions

The Challenge: CastCo, a manufacturer of large steel cast parts for the transportation industry, had been purchased by a PE firm, a long-time Gotham client. Ahead of the deal, Gotham's operational due diligence investigation had identified significant opportunities to streamline operations and reduce material spend at CastCo. With an over 100-year history, CastCo had gone through bankruptcy 6 years earlier and had shuttered operations for about a year until the management team was able to raise enough capital to restart the operations. Although when the PE firm took ownership, the business had been back in operation for almost 5 years, CastCo was still putting operational basics in place, including new operations leadership, systems, and processes. Post-deal closure, Gotham had visited with the CEO and the PE Operating Partner to review our due diligence findings vis-à-vis material cost reduction opportunities. Our discussions: confirmed our initial findings of significant inefficiencies in sourcing and purchasing practices (vendor fragmentation, undisciplined purchasing and sourcing processes, etc.); and elevated material usage as a critical, untapped cost reduction lever. CastCo's CEO then asked Gotham to lead the effort to assess and plan for the capture of material cost savings opportunities.

The Partnership:

Analysis: We launched a 3-week diagnostic to get a handle on the facts by: developing a detailed fact base on purchasing and material usage history; mapping CastCo's current purchasing and sourcing processes; and benchmarking commodity prices against applicable indices. The enterprise system in place at CastCo was nearly 30 years old and did not have the capability to export a historical account of purchases to use as a data set. Given the significant purchasing complexity at CastCo (7 item classes in 55 major commodity codes with 3,000+ total materials purchased), Gotham used creative analytical technologies to translate ASCII reports into a usable database loaded with the monthly historical reports.

From our fact-base and experience, we established that while steel and ferroalloy feedstock pricing closely tracked indices and were competitive with market pricing, the remaining half of CastCo's \$50+MM spend presented a cost reduction opportunity of \$3.3-5.5MM (13-22% of total material spend), concentrated in four major areas:

- **Commodity Price Clawbacks:** Commodity price drops not yet recovered from vendors
- **Prices Above Benchmarks And Ineffective Sourcing Processes:** Significant vendor fragmentation and use of legacy vendors (in some cases for 5+ years); no processes for re-bidding vendor contracts or vetting pricing; and no material cost reporting (due in part to legacy system limitations) and material cost management processes
- **Usage Excesses:** Untracked, uncontrolled usage, partly driven by high manufacturing scrap and rework levels
- **Expense Items:** Over \$2MM in annual untracked, non-centralized expense purchases (30+ employees authorized to expense items with high expense limit, resulting in questionable spending).

Strategy: To capture CastCo's material cost opportunities, we proposed a three pronged approach: (1) tackle the top 6 commodities to reduce purchasing spend through vendor consolidation, re-sourcing, and/or renegotiation; (2) develop tools to allow robust, ongoing reporting and analysis capabilities for both purchasing and usage performance; (3) implement improved purchasing procedures to eliminate wasteful and unnecessary expense spending.

Execution: Gotham helped the client team launch the implementation phase. We developed the bid/renegotiation packages and prospective vendor lists for the subsequent RFP processes for CastCo's top 6 commodities. We also created and rolled out 2 simple tools to enable reporting (despite the legacy systems limitations) on both purchasing and usage performance – this was the first time CastCo was able to access actionable reporting, exciting the management team, and spurring improvement activity.

The Outcome: With increased visibility to spend, CastCo has already reduced usage by 3%, generating \$1.2MM in savings. Additionally, several of the top 6 commodities identified for re-sourcing/renegotiation are completed and generating anticipated savings, with the remaining commodity RFP efforts underway.

