Mary Drotar

Viewpoint

# "Help! Save me from 'Target Costing'—everything around me is breaking!"

Mary Drotar, Partner, Strategy2Market, Inc. (mdrotar@strategy2market.com)

*The author explains that* Target Costing *is arguably one of the single greatest contributors to the poor quality of products in today's marketplace. Product innovators like to tell us that beautifully designed products needn't cost more to manufacture. I argue that, in many cases, this is true. However, it is also true that a product doesn't have much to offer in the beauty department if it routinely fails to survive the rigors of use for which it was supposedly designed—whether that's within the first few months or after years of service. So what is* Target Costing*?*

Target Costing is defined as a cost-management tool for reducing the overall cost of a product over its entire life cycle with the help of production, engineering, research, and design. A target cost is the maximum outlay that can be incurred on a product while still meeting the required profit margin at a particular selling price.[1]

It's all about reducing COST. This all too often involves the use of cheaper components and materials, including those that are less robust, less reliable, and more likely to fail during normal use. This can translate into shoddy products with a short working lifespan. You may ask, "Why is this so important?" Well, when in terms of cost savings, you'd surely want to avoid the kind of mistake the following company made.

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Back in the mid-1990s, a manufacturer of small kitchen electrical appliances was considering its options for reducing costs. They contracted with a supplier in the Far East to produce circuit boards for an electric grill designed for the U.S. household market.

The initial run of circuit boards met all the quality criteria and operated according to specification. However, without notifying its customer, the circuit board supplier, as a means of reducing its own production cost, began using different, less costly materials. The lesser-quality circuit boards began to fail prematurely. Consumers started returning the defective electric grill to the stores, and the stores in turn returned them to the manufacturer and ceased carrying any of the manufacturer's products. Without the possibility of selling any additional new products, the manufacturer couldn't absorb the cost of all the returns and soon went out of business.

Bearing this in mind, and assuming that you care about the reputation of your company, ask yourself: "What would Target Costing mean for my end-user customers?"

## Speaking of feeling ripped off!

A few years ago at a Target Costing presentation hosted by the American Society of Mechanical Engineers (ASME), the speaker offered some basic principles of Target Costing—cutting materials cost, decreasing the product life, and so forth. An audience member neatly summed up the ludicrousness of this whole approach with the remark: "You mean Target Costing is the reason the windows in my $1 million home were replaced within three years!"

Yes, it happens to all of us. The list of failed products is extensive, especially in the area of consumer electronics, examples of which we can probably all identify with. According to an analysis conducted by Accenture, the customer return rate for consumer electronics in the United States averaged 11 to 12 percent. It cost the U.S. electronics industry $13.8 billion to rebox, restock, and resell the returned items.[2] Based on my personal experience, these are some of the products that I've purchased over the last three years that failed within 3 to 12 months:

- Vacuum cleaners (two times)
- Stereo systems and components (CD player, DVD player, headphones)
- Desktop computer
- Printers (two times)
- Phone systems (three times)
- Beautifully designed Target brand lamps (two times) and trash cans (two times)
- Fax machine

Now ask yourself where the sense is in paying up to $500 for a premium vacuum cleaner, when you can purchase a 15-year-old Oreck from a garage sale for only $20 that still works better than the three shiny brand-new bagless wonders that I purchased over the last three years.

Like you, I'm willing to pay extra for a product that's designed and manufactured for a longer life, but clearly not 5 or 10 times the price. For instance, how much do you need to pay for a one-piece iPod docking station to help you get more out of your music collection at home?

Have you noticed all the awful reviews for music player docking stations sold through the big online retailers? Yes, to get something well made, reliable, and capable of doing what you ask of it, you have to spend a bundle—more than the $50 or $100 check that Aunt Agnes sent you for your birthday (to avoid your total disappointment, Aunt Agnes might try looking at a check in the $500 to $1,000 range). But then you'd say to yourself: "But I could get an entire stereo system for that price!" Here's a perfect example where new product developers could fulfill unmet consumer needs, in this case, by offering a reliable, high-quality docking station priced 25 to 35 percent above those-low quality products.

### So what is a product developer to do?

Start with your innovation/product strategy, and discuss the ramifications of Target Costing. Find out if it's alienating your customers or if there's any white space for high-performing innovative products (white space is that undiscovered domain of opportunity for new products and new markets).

To identify white space, try using the strategic tool Perceptual Mapping.[3] It's based on consumer perceptions about your products and brand, relative to your competitors. This is crucial for staking out a valuable place that can provide a long-term competitive advantage for your company and its products.

Investigate online magazines and product reviews. Online retail sellers, such as Amazon, encourage customers to provide feedback (customers are evidently far from shy when sharing their faulty product experiences). Based on these reviews, where do you and your competitors fall short on performance, and where can you improve relative to your competitors?

So, when developing your product requirements document, don't merely list target cost, but also consider things like reliability and the mean time before failure (MTBF). Be sure to test your supplier components on an ongoing basis, and be aware of your supplier's motivations to reduce costs.

Spend time reviewing your warranty records and talk to your Quality Department and Customer Service Representatives. Analyze the type and number of complaints. Require your new product development team to spend a period of time answering the telephone help lines or processing returned goods.

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Try to be different in the marketplace. Develop a value proposition for making products that last longer. Pursue and embrace your potential to gain and retain customers through good product development practices. V

### Endnotes


1. Robin Cooper and Regine Slagmulder, *Target Costing and Value Engineering* (New York, NY: Productivity Press, 1997)
2. Sohrab Vossoughi, "Consumer Electronics: Innovate or Die," *BusinessWeek* Online (January 1, 2009): p. 50.
3. For more on Perceptual Mapping, see *Staking Out Valuable Positions,* Strategy2Market, Inc. (February 2007) *http://www.strategy2market.com/downloads/perceptual_mapping.html*