Involving suppliers when developing a new product or service can be smart. But, if not done well, early supplier involvement can lead to suppliers taking advantage of customers who lack the future threat of competition to reduce costs and improve performance.

I’ve studied this problem and found companies using these tactics to control early supplier involvement deals:

1. **Make Cost Data Sharing Mandatory.** For the privilege of their involvement in development, a supplier should be required to break down its quoted price into its component costs and profit margin.

2. **Minimize The Overhead Percentage.** Scrutinize how overhead is calculated. Re-identifying overhead costs as direct costs makes it easier to jointly reduce those costs later. For example, costs associated with scrapped material might be buried in overhead. That should be made its own line item.

3. **Understand All Assumptions.** There are always assumptions built into a supplier’s cost structure. For example, a supplier may base its labor costs on an assumed production rate (e.g., 100 units per hour). Document all of these assumptions and have a technical team member evaluate their accuracy.

4. **Agree To The Right Terms.** Suppliers who overestimated their costs (or intentionally quoted them higher) should not benefit. So pricing should be based on a cost plus fixed fee scheme. Suppliers must agree to share accounting records of their work for you. And you should agree on the terms that can change if the volume exceeds your estimates.

5. **Audit The Supplier’s Books.** You and your technical team must audit the supplier’s records to compare actual costs versus estimated costs and those assumptions you documented earlier with actual results. Where costs were lower than estimated or actual performance was better than assumed, a price adjustment is warranted.

6. **Continuously Evaluate Cost Reduction Opportunities.** Auditing supplier’s books can also involve evaluating ways to reduce costs. Try to identify materials used by several suppliers to see if consolidating the buy can reduce costs.

Use this approach to help ensure that your purchasing department is valued in early supplier involvement deals.

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