



TenStep Supplemental Paper

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The Cost of Poor Quality

An American manufacturing unit recorded annual sales of \$100 million. Its quality department did a study on the impact of all aspects of poor quality. It analyzed and calculated the total sum of the costs of repair, rework, scrap, service calls, warranty claims, lost sales, and other non-value added activities. This sum was called Cost of Poor Quality (COPQ) and it surprisingly amounted to 20% of the annual sales. This number implies that during one day of each five-day workweek, the entire company spent all its time and effort remedying for poor quality, representing a loss of approximately \$80,000 per day. Remember that this is not just obvious scrap and waste, but also the cost of service calls, warranty claims, lost sales, etc.

US experts have estimated that COPQ amounts to 20-40% of gross sales for most manufacturing and service companies. Independent studies reveal that COPQ costs companies millions each year, and its reduction can transform even marginally successful companies into profitable ones. Still, most executives believe that their company's COPQ is less than 5%, or they do not know what it is at all.

Expressing the loss as a percentage makes COPQ easier to ignore. When identified as money, facilities, material, equipment, inventory, and human effort wasted, its company-wide impact is quickly apparent. Measurable improvements are achievable within the first six months by identifying internal and external costs of poor quality and subjecting them to a Pareto analysis. The results of this analysis represent most of the money that is lost due to poor quality.

Today's archaic cost accounting system is a major obstacle for companies attempting to reduce COPQ. Most accountants admit that their detailed product cost data does not represent actual costs. To overcome this, the quality assessment team should perform the initial task of developing the categories of the cost of poor quality. They should also determine the appropriate ways to account for poor quality. For instance, each rejected product should be considered at its sales price since the poor quality will result in a sale that cannot be made.

After the company COPQ report is established, it should be verified by the cost accountants and then accepted within the company. The initial costs will provide a benchmark against which improvements or temporary setbacks can be measured. A monthly, highly visible COPQ report recommending action should be released and considered by top management. Improvements will not happen if the results are not measured and reported in monetary terms.

The acceptance of the current practice of labeling rejects, rework, scrap, waste, returns, and poor-quality discounts as non-value-activities means continuing to lose money. Reduction of COPQ can improve productivity, profit, sales, product quality, service quality and overall company results - all with little or no investment.