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The 2027 Margin Is in the Supply Base

Why 2027 cost reduction plans must run through direct materials, and why most won't get there

By Scott Brewer

Executive summary: Target 8 to 15% in structural material cost reduction

Every executive in Arcpath's 2027 planning survey plans to cut costs next year. Not most of them. All of them. They also agree on the problem. 95% name input cost inflation in materials and components as a top 2027 headwind, well ahead of competitor pricing at 45%.

The hard truth: the cost plans don't match the problem. Most 2027 savings are expected to come from cost of goods sold (COGS). Inside COGS, the biggest pool is direct materials, typically 50–70% of the total. Yet only 15% of respondents plan supplier consolidation or renegotiation, and only 10% plan design-to-cost.

Companies that buy direct materials the usual way tend to report 2–3% savings a year. In our experience, the structural opportunity in most supply bases is 8–15%. That gap is where the 2027 margin lives.

Below we lay out what the survey and our Q3 2026 benchmarks say about 2027, why direct materials is the place to start, where current plans fall short, and what a plan that delivers looks like for your demand profile.

2027: optimism, with a squeeze on earnings

Executives are upbeat: 70% are more optimistic about 2027 than a year ago, and none are less optimistic. The average 2027 revenue growth target is 6.1%.

Third-quarter results back that up, with a caution. Among the 162 companies in our Q3 2026 briefing that had reported by November 5, 2026, revenue grew 8.0% and EPS 13.5% year over year. Results are strong but no longer accelerating. Our executive sentiment index slipped to 71 from 74 in Q2. 53% of companies raised full-year guidance, but 23% lowered it, up from 16% in Q2.

Growth isn't spread evenly, so we grouped respondents by the demand they expect in 2027:

Demand group	Share of respondents	Avg. 2027 growth target	Avg. 2027 cost reduction target (% of net sales)
Very strong demand (AI supply chain, defense, capital spending)	45%	9.4%	2.3%
Resilient demand	30%	4.7%	2.3%
Broad consumer markets	25%	1.6%	3.2%

Two things squeeze earnings in all three groups.

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Inflation is back on top

95% cite input cost inflation as a 2027 headwind. The earnings releases show it spreading. 30% of companies cited inflation as a risk in Q3, against 16% of the same companies in Q2. In Chemicals it's 79%; in Consumer Products, 46%. Some companies point to the Middle East conflict pushing up raw material and distribution costs.

Pricing has limits

80% plan pricing actions in 2027. Companies with strong demand can price strategically, through new pricing models or outcome-based contracts. If demand weakens as interest rates rise, pricing turns tactical. In broad consumer markets, every company plans price, discount or rebate actions just to hold volume.

Q3 shows why. Consumer Products revenue grew only 1.8%, and more than two in five of these companies cite weak consumer spending. Most are leaning on cost and productivity gains to protect earnings. Nearly a third also cite price increases.

When price can't carry the load, cost has to.

Go where the money is

Doctors have a principle called Sutton's Law, named for Willie Sutton, the 1930s bank robber who reportedly said he robbed banks because "that's where the money is." When diagnosing a problem, start by testing for the most obvious cause. For example, a patient with chest pain gets checked for common heart problems first, not rare ones. This is the most expeditious and efficient way to provide care.

The parallel to business is straightforward: when margins tighten, target the highest-cost components. However, it doesn't always work that way in practice. Often, companies cut overhead and freeze hiring before taking a hard look at the structural cost in their supply base.

The survey shows COGS carrying most of the 2027 savings load in every group:

Demand group	Total cost reduction target (% of net sales)	Portion from COGS	COGS share of the target
Very strong demand	2.3%	1.2%	~52%
Resilient demand	2.3%	1.4%	~61%
Broad consumer markets	3.2%	2.5%	~78%

Across all respondents, the planned 2027 benefit is 1.6% of net sales from COGS and 0.9% from G&A.

Direct materials typically run 50–70% of COGS, making them the single biggest cost on most manufacturers' income statements and the most direct way to hit a COGS target.

How the math works

Take a $1 billion manufacturer, using round, illustrative assumptions:

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Line	Assumption	Amount
Net sales		$1,000M
COGS	65% of net sales	$650M
Direct materials	60% of COGS	$390M
2027 COGS savings target	1.6% of net sales (survey average, planned)	$16.0M
Materials inflation to absorb	3% of direct materials spend	$11.7M
Direct materials savings needed		$27.7M (~7.1% of spend)

That 7% assumes direct materials carry the whole COGS target. They won't: 80% of respondents also plan direct labor productivity gains. Still, a company getting 2–3% a year from direct materials will come up short and have to find the rest elsewhere.

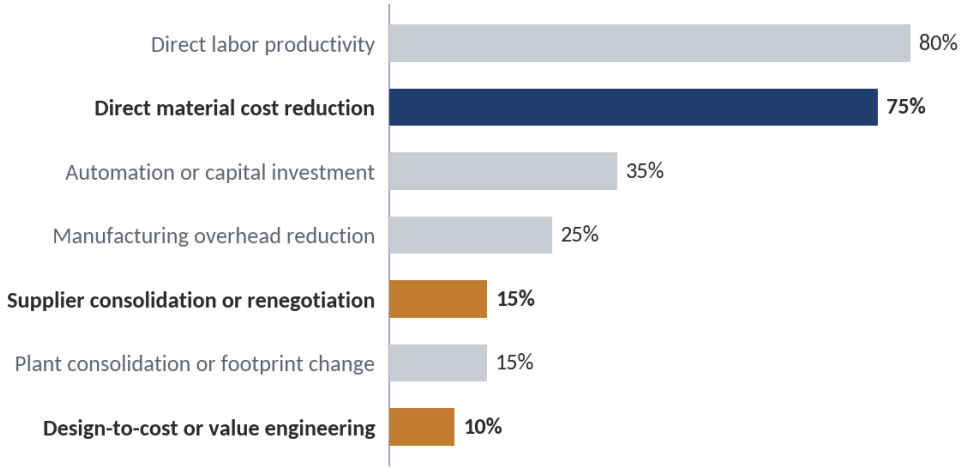
The plans don't match the problem

Most companies say the right thing. 75% plan direct material cost reduction in 2027. In broad consumer markets, it's 100%.

The picture changes when you look at how they plan to get there.

75% plan direct material savings in 2027, but few plan the levers that change what they pay

COGS initiatives planned for 2027, share of respondents (up to three each)
Navy: the goal. Gold: the two sourcing levers that change the cost of what you buy.



Source: Arcpath 2027 Planning Executive Survey, September to October 2026

Only 15% plan supplier consolidation or renegotiation, and only 10% plan design-to-cost or value engineering: the levers that change what you pay for what you buy. Without them, most companies are planning to get 2027 direct material savings from the same process that produced last year's number.

Why 2–3% keeps showing up

In our experience, most direct materials programs land at 2–3% a year. The reasons are familiar:

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- **Three quotes and pick one.** Purchasing collects three quotes, picks an acceptable price and moves on. Nobody checks whether it's the best total cost.
- **Price-downs that aren't.** Suppliers agree to an annual reduction, then win it back through engineering changes, new part numbers or surcharges.
- **The new part tax.** Suppliers charge unjustifiably higher prices for new or modified parts, even when the change has little or no effect on material cost or manufacturing effort.
- **Increases that never came back.** Many supply bases still carry pandemic-era price increases that were never unwound.
- **Identified isn't realized.** Savings get counted when a quote comes in, not when they show up in COGS.

A disciplined direct materials process routinely finds 8–15% in the categories it addresses. The gap between that and 2–3% is the opportunity most 2027 plans are leaving on the table.

The Q3 filings point the same way: 36% of reporting companies cited a cost program, up from 31% in Q2. Those that put a number on it averaged 1.4% of annual net sales, down from 1.7%. More companies are cutting cost, and the stated savings are getting smaller. Where companies name the source, most of the savings come from supply chain, not SG&A.

What the filings imply for direct materials

Now apply the Q3 numbers. Companies that state their savings average 1.4% of net sales; part is labeled supply chain, and part isn't allocated to any area. Assume 1% of sales comes from the supply chain.

Step	Assumption	Result
Supply chain savings	Supply chain share plus part of the unallocated savings	1.0% of net sales
As a share of COGS	COGS is 65% of net sales	1.0% ÷ 65% = ~1.5% of COGS
As a share of direct materials	Direct materials are 60% of COGS, or 39% of net sales	1.0% ÷ 39% = ~2.6% of materials spend

That assumes every dollar of supply chain savings comes from materials. Some will come from freight, warehousing or plant labor, so the real number is lower.

Either way, it lands where most programs stall: 2–3% a year.

Compare that with the $1B example: to hit the survey's planned COGS target and absorb 3% materials inflation, a typical manufacturer needs about 7% from direct materials. The programs companies are announcing get them just over a third of the way.

One survey, three different direct materials problems

The right direct materials plan depends on the demand you're facing. The survey shows three very different starting points.

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Demand group	What the survey shows	Where direct materials effort should go
Very strong demand	33% cite supply or material availability as a headwind. 56% plan automation or capital investment. 56% plan direct material cost reduction.	Secure supply first, then cost. Qualify second sources before you need them, get visibility into tier-2 suppliers, and revisit make vs. buy on constrained parts.
Resilient demand	83% plan direct material cost reduction. 50% cite competitor pricing or low-cost imports. Pricing is split evenly between strategic and tactical.	A full sourcing reset. Re-bid major categories against the global market and bring engineering in to open up specs.
Broad consumer markets	100% plan direct material cost reduction and 80% plan manufacturing overhead cuts. 100% cite weak demand. Highest cost target at 3.2% of net sales.	Structural cost-out, fast. Total landed cost, design-to-cost and a tighter supply base.

Very strong demand: don't skip direct materials

This is the group most likely to put direct materials on the back burner. Demand is strong, margins look fine, and the priority is getting product out the door.

That's exactly when your negotiating power disappears. A supplier that knows it's your only source, and that your customers are waiting, has little reason to hold price. The 33% citing material availability is an early warning: dual sourcing takes 12–18 months to do well, so start before the shortage, not during it.

Resilient demand: the incremental approach has run its course

These companies have the most room to act and the least urgency, which is a risk. Annual RFQs and price-down letters have been run so many times that suppliers know the drill. A step change means rethinking the categories, re-benchmarking the market and getting purchasing, engineering and finance working from the same numbers. Direct materials sourcing programs, as an ongoing part of supply chain and product design practice, are critical to ensure waste doesn't build up in your income statement and impair flexibility later, when demand is less resilient.

Broad consumer markets: cost is the only lever left

These companies have no tailwind, flat-to-falling base business, no pricing power and the highest cost target. Every one plans direct material cost reduction; the question is whether they'll get 2% or 10%. With a 3.2% total target and 2.5 points expected from COGS, the difference decides whether 2027 earnings hold. Aggressive, continuous efforts are critical.

What step-change savings take

Nothing about these levers is secret. Most procurement teams could name them. The difference is execution.

Golf makes the point. In 2026, the world's #1 player averaged 67.86 strokes a round on the PGA Tour, and the #50 player averaged 68.98. That gap of about one stroke a round, a scoring edge of roughly 1.6%, was worth about $27M in official prize money: $31M for #1 against $4M for #50, nearly eight

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times as much. Sourcing works the same way. The process isn't different; the execution is, and small differences add up to big dollars.

A direct materials program has to get six things right:

1. **Size the opportunity with facts.** Start with spend by category, supplier and part family; not every category deserves the same effort. The data won't be perfectly clean, and no software makes it so. Someone has to do the cleanup.
2. **Know the cost before you negotiate.** You can't negotiate well without understanding the supplier's cost structure, its process capability and your alternatives.
3. **Create real competition.** Qualify new suppliers and compare them with incumbents on total landed cost, including freight, packaging and tariffs. A part can still be cheaper after paying the tariff.
4. **Open up the design.** When an RFQ draws few bids, the problem is often the spec, not the market. Bring suppliers in early to suggest material or process changes, then re-quote once the design is locked.
5. **Fix the structure of the supply base.** Dual-source where one supplier holds too much of the business, and revisit make vs. buy and whether to buy components or finished assemblies.
6. **Lock it in.** Execute the contracts, manage the supplier transitions so launches aren't disrupted, and track savings to the P&L.

Results from five categories

Our team ran these engagements for global agriculture and construction equipment manufacturers: same process, different categories. Annual savings ran from 12% to 28%, against the 2–3% most programs report.

Category	Annual spend	What was holding cost up	What changed	Annual savings	Fewer suppliers
Hydraulic cylinders	$150M	Suppliers owned the designs. Incumbents were priced 30–50% above peers in the same region.	Parts grouped into families by weld process and spec. Dual-sourced across best-cost and in-region suppliers. Shared IP on future designs.	Over 25%	Over 33%
Hydraulic fittings and couplers	$65M	Custom and commodity fittings bought from the same suppliers. Suppliers owned the IP on custom parts.	Standard and custom parts split. Manufacturers chosen over distributors. Shared IP and transparent pricing.	Over 28%	Over 34%
Hydraulic hoses and tubes	$150M	More than 15,000 SKUs. Awards based on short-term supplier capacity.	Global manufacturing with in-region assembly. Engineering cut part proliferation through reuse.	Over 23%	Over 50%
Machined castings	$300M	More than 300 suppliers. Only a few parts re-sourced each year.	Four-tier part classification. Three or more new suppliers bid for every incumbent.	Over 12%	Over 60%

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Category	Annual spend	What was holding cost up	What changed	Annual savings	Fewer suppliers
Raw castings	$500M	Fragmented buying. No raw material index. On-time delivery below 70%.	Transparent pricing to stop the new part tax. Raw material indexing. A 99% on-time commitment. Dual-sourcing based on part criticality.	Over 12%	Over 50%

Together, that's about $1.2B in spend and more than $180M a year in savings, roughly 16%.

The biggest savings came where suppliers owned the designs and prices hadn't been tested in years. In every category, the supply base got smaller, not bigger.

If it doesn't reach the P&L, it doesn't count

One of the five recommendations in our planning survey is to set cost targets by initiative and tie each to a specific P&L line. That matters most in direct materials.

We often see the same pattern: purchasing reports savings every year, and COGS doesn't move. Both can be true at once, because the savings were measured against a quote rather than the last price paid, cost avoidance was counted as savings, or the gains went out the door with the next round of engineering changes.

A program built to reach the P&L measures a few things differently:

- **Price paid, not price quoted.** Compare this year's price with last year's price on the same parts, at actual volumes.
- **Net of increases.** Supplier increases and surcharges come out of the savings number.
- **New parts count.** Track what new parts cost compared with the parts they replace.
- **Executed, not identified.** A saving counts when the contract is signed and the parts are shipping at the new price.

This is also where buyers and boards draw the line. A saving that's still a plan gets discounted. One that's in an executed contract and showing up in the numbers doesn't.

The cost of waiting

Suppose your direct materials opportunity is $60M a year, or $5M a month. Start in July instead of January and you've given up $30M of 2027 savings. Not deferred, not delayed. Gone.

A full program takes 12–18 months to reach executed contracts across the major categories. Early categories can show results sooner, but the calendar matters: a plan that waits for the final 2027 budget to start sourcing has already given up part of 2027.

What to build into your 2027 plan

1. **Put a number on direct materials by category.** A blanket 2% target tells nobody what to do. A target by category, with an owner, does.
2. **Plan the method, not just the target.** Name the categories that will be re-sourced, redesigned or dual-sourced in 2027.

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3. **Take tariff refunds out of the baseline.** They won't repeat, and they shouldn't hide a weak cost plan.
4. **Match the plan to your demand.** Supply security first if demand is very strong. A sourcing reset if it's resilient. Fast, structural cost-out if you're in broad consumer markets.
5. **Measure what reaches the P&L.** Price paid against last year, net of increases, on executed contracts.
6. **Start now.** Every month of delay is savings you don't get back.

Willie Sutton knew where the money was. For most manufacturers in 2027, it's in the supply base.

About Arcpath Consulting

Arcpath Consulting is a business transformation firm that takes companies and investors from board-level strategy through implementation. Seasoned practitioners partner with clients throughout the transformation journey — their work made faster and more consistent by an AI-Native platform that carries benchmarks, models, and proven templates from one engagement to the next.

Sources and notes

- Arcpath 2027 Planning Executive Survey, responses collected September to mid-October 2026, with interviews conducted alongside the survey. Respondents: CEOs or presidents (45%), CFOs (40%) and other senior executives (15%) across consumer products, industrial equipment, healthcare and life sciences, technology and business services, and energy, chemicals, aerospace and defense. Cost averages use range midpoints, and 3.5% for responses over 3%.
- Arcpath Q3 2026 Executive Briefing: Quarterly Performance Summary and Benchmarks, November 6, 2026. Covers the 162 of 207 US public companies in six sectors that had reported by November 5 (94% of the group's revenue), from Q3 2026 earnings releases and SEC filings. Q2 comparisons use the Q2 2026 briefing as revised November 6. Tariff refunds and one-time charges are excluded from profit measures.
- Direct materials share of COGS (50–70%) and savings opportunity (8–15%) reflect our team's sourcing engagements across manufacturing industries.
- The $1B manufacturer and the $60M opportunity are illustrations, not client data.
- Case results are anonymized engagements delivered by our team.
- Golf comparison: Official World Golf Ranking as of November 2026. Scoring averages are the PGA Tour's 2026 field-adjusted scoring average; earnings are 2026 PGA Tour official money.

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