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WHITEPAPER

Finding the Hidden Profits in Manufacturing Businesses

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Let's start with a few questions?

- [ ] Are you achieving capital expenditure paybacks of around 15% on funds employed?
- [ ] Is profitability at least at 10% of sales?
- [ ] If your company is winning new business at reduced margins ... Is your bottom line growing as quickly as your sales?
- [ ] Is your growth being funded without borrowing money?
- [ ] Are you implementing key strategic objectives and initiatives on time?

If you answered no to any of the questions above you need to question how your business and management is going to get back on track. This paper is designed to assist. Read on...

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Executive Summary

The goal of this white paper is to shine a light on the financial performance barriers and growth inhibitors that many food manufacturers experience. In today's ever competitive business landscape, you can't afford to be complacent as things won't change doing more "of the same". To sustain revenue performance and business growth you need to be "leading the pack" in terms of innovation and efficiency.

Why?

There are often many reasons why a business isn't delivering the financial performance required. It may be something that is quite clear or it maybe a number of things that are less obvious -"that's the way we have always done it".

Whatever the reason, now is the time to resolve the issues and implement the changes needed to drive profitability and growth.

We work with a broad spectrum of manufacturing businesses nationally, yet, I am often surprised to see the same issues appearing across these disparate organisations. We can usually look at a few key areas and help our clients to achieve some quick wins but the real challenge is to implement a Continuous Improvement culture and process that will sustain the improvement initiatives and engage the employees.

So let's look at a few of the most common reasons why a business isn't achieving its profitability targets.

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Financial

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Financial Numbers

The numbers don’t lie, yet, they don`t always identify the cause of a problem and definitely don`t show you how to improve it. They are usually just the first step we take when trying to determine business performance issues.

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Stock turns

Stock turnover is a key measure of operational policies and stock management, it tells us the frequency of stock turnover v's sales for a given period. A low stock turn rate would indicate that production is pushing through stock at job lot quantities well over the pull from the customers. This results in excess stock and blocking out production time that could have been used to produce products that customers are now forced to wait longer for.

A high stock turnover rate could also indicate there is a high level of downtime due to increased make-ready times whilst swapping and changing products.

It is certainly a challenge to balance customer satisfaction and minimise excess stock that ties up working capital. We work with our clients and their customers to get the balance right and the solution is often a lot easier to achieve than businesses expect.

Stock Turns are calculated in a variety of ways. However, one of the most common ways is to divide total sales COGS by average inventory value.

The formula therefore is:

cTurnover = Total Cost of Goods Sold / Average Inventory

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Stock Turns - Question

Are you achieving 10 to 12 stock turns annually or are your stock turns under 5, resulting in WIP sitting on the factory floor taking up valuable storage space as well as impacting your cash flow? If your business is fine tuned to market needs then it should be producing just enough to meet customer demand without storing excessive levels

Notes

Debtors/Creditors

This should be an obvious area to look but you'd be surprised at how often we find debtors running at over 60 days and sometimes at 90 days. They should be sitting around 30 days and certainly under 40 days in order for optimal cash flow.

Debtor management is crucial. If you have delinquent clients then ensure this is factored into the price or better still, find better paying clients to replace them.

When we undertake a debtors review we often find that the worst payers are the "bottom feeders" who are small volume and usually are the ones who play the field with suppliers (no loyalty).

For imported goods, have you considered negotiating "on consignment terms", it doesn't make sense to pay for goods that will sit on a boat for weeks at a time. Consider negotiating payment when goods arrive at your premises. We find many businesses do not price in the cost of money or the cost of additional storage when comparing local supply verses imported supply.

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What are your most profitable products?

Tip - look at the $$$'s not the percentages!

We regularly speak with CFO's and Finance Managers when working on a business transformation. Inevitably the discussion comes to how do we know what products make the business the most profit. The typical response is we measure product profitability by the gross margin percentage. I challenge this understanding by asking them when was the last time they purchased something with a percentage.

Of course you can't purchase anything with a percentage, you need cold, hard cash!! We then take them down the journey of re-evaluating their products by comparing the dollar value add per hour which can give you a very different appreciation on what products make the most money. We are in business to earn the maximum dollar contribution per hour and this may well be higher on lower gross margin percentage (GM%) products than higher gross margin percentage products. Take the challenge in your business and do the exercise!! Then apply the target dollar per hour number, e.g. $1,000 per hour, as your new measure of evaluating what work you want to bid for and let the opposition quote on the gross margin percentages.

You can't bank percentages, only dollars, so insist that everyone speaks in dollar values!

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Example

Let me give you an example. If I asked you to choose a product that was more profitable - which one would you select? Assuming each product takes 1 hour to manufacture or process.

Product A costs $60 to manufacture, let's work on a 50% mark-up therefore it sells for $90, the gross margin on this product is 33%. This gives a $30 hour margin dollar contribution.

Product B costs $100 to manufacture, we work on a 40% mark-up therefore the product sells for $140 and has a 28% gross margin. This gives a $40 hour margin dollar contribution.

Traditional thinking is to select Product A at the higher margin, 33% versus 28%. However when we look at the gross margin dollars per hour, Product B contributes $40 per hour versus Product A contributing $30 per hour, that's an extra 33% contribution!

Ensure you know your gross profit dollar amount per hour, this is the magic number to track against for all products. It's also advisable to monitor it against last year's numbers, if your business is improving its efficiencies then this amount will also improve. If it's not, then investigate WHY?

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Operations

Waste

We are regularly surprised by the amount of waste that occurs in a manufacturing business. Do you know where the waste is in your organisation and are you able to identify how to reduce it? How long has it been since you challenged the "waste allowances" in the standards!

Waste can be within the manufacturing process or as we often find, in wasted human capital resources. Yes it sounds obvious but some forms of waste can be difficult to spot.

Some areas to look for waste include:

- Over-production
- Unnecessary transportation
- Inventory
- Motion
- Defects
- Over-processing
- Waiting

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Operational equipment effectiveness

The overall equipment effectiveness (OEE) indicator is an important measurement of facilities utilisation and can indicate if there are performance issues within your business.

Your OEE measures Availability, Performance and Quality. By breaking it down into these key areas it is easier to identify issues and bottlenecks within the manufacturing process.

What should your OEE be?

We usually set the benchmark at around 85% for the bottle neck process.

It is important that we do not get too carried away with trying to maximise the OEE for non-bottleneck machines. For these machines we need to trend that the OEE is not falling and that the output rates are consistent to maintain the speed of the total supply chain (The drum beat of the production line).

When the OEE of the bottle neck machine improves, then we need to increase the output of the other processes to keep in pace with the increased output of the bottle neck machine to maximise line efficiencies.

How do you calculate the OEE?

OEE is calculated with the formula - (Availability)*(Performance)*(Quality)

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What gets measured gets managed!

Do you have a visual workplace management process in place?

A system that measures daily performance around safety, quality, delivery and cost targets is crucial. We find that a daily focus on these measures in both operational and administration areas of the business is vital in challenging the business to identify issues and sustain a Continuous Improvement culture.

A visual workplace management process is an effective way to maintain performance momentum as well as a great way to engage your employees in any improvement process.

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Efficiency

Are you able to easily identify bottle necks on the manufacturing floor?

Are there daily department meeting on department performance? Are these tracked in any way? Are Issues Resolved promptly?

Often these hold-ups can be costly and if they are not monitored can be a major profit leak, it's a good idea to implement weekly reporting on this data.

Is a supplier causing delays?

Hold-ups in the supply chain can also impact productivity, if a supplier is regularly missing delivery dates, it may be time to source a new supplier. Again, regular reporting on this data will make it easier to track delays and provide the data you need to request compensation if the delays have been extensive or costly to your business.

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People

Your People

Your staff is one of your businesses largest expenses yet, your most valuable asset when managed correctly. Your people represent the greatest possible competitive advantage you have. Ensure you are hiring and managing employees correctly. Failing to do so can impact productivity and hinder innovation.

When the workforce is aligned with corporate strategy everyone is pulling in the same direction and it's easier to achieve growth and profit targets.

Questions ???

- ☐ Is your workforce engaged and accountable for their performance?
- ☐ Are company departments working together to deliver an effective internal supply chain or is the business structured and rewarded around internal silos?
- ☐ Has your business conducted an employee engagement survey? If so when?
- ☐ Is the workforce aligned with company strategy?
- ☐ Do you have low employee turnover?
- ☐ Is your absenteeism within acceptable levels?
- ☐ Are employees invited to share new ideas and innovation?
- ☐ Do you have a recognition and acknowledgement culture?
- ☐ Is your safety performance resulting in increased workers compensation insurance - Is your company committed to a zero harm policy?

If you answered no to any of the questions above you need to question how your business and management is going to get back on track Read on...

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Sales, Marketing and Branding

Sales growth and development

The area that most organisations consider vital for increased revenue is sales. This is not always true, if your processes are inefficient, or the organisation has excessive waste or worse still you need to review pricing models, then sometimes additional sales can just increase the burden. The gap between revenue and profit will continue to shrink and service levels may be impacted. Sometimes extra sales only add pressure and stress to an inefficient business resulting in worse customer service and delivery.

Though, when everything else is aligned and working efficiently then increasing sales is an effective way to increase revenue.

Developing your sales team and capability is a highly effective and low cost way to increase revenue. For example, if sales conversion rates improve from 1 in 4 to 2 in 4 (that's two sales from every four leads), then you will double sales volumes without spending any additional funds on marketing.

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The right people in the right roles

In order to maximise sales results it's vital to have the right sales personalities in the right roles.

If your sales team aren't performing as well as you hoped, is it time to rethink the structure? Perhaps dedicated account managers that look after existing clients may be more effective than having highly paid, senior sales people calling on existing clients and picking up orders.

Perhaps a more cost effective solution may be to restructure and direct low value / transactional sales to an inbound tele-sales team or an on-line ordering system, allowing the more highly paid sales folk to focus on larger dollar sales and new customers.

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The sales persona

Understanding the different types of sales people and their relative strengths and weaknesses will ensure you structure your team effectively. There are four types of sales people:

1. The Hunter/Closer

This type of sales person is usually a career salesperson, they thrive on the win and large commissions. Typically, they are not big on paperwork and can sometimes be viewed as tardy. It's vital to engage this type of sales professional by understanding their motivations and keeping them engaged and reporting in regularly. This is the ideal sales person for chasing new clients.

2. Consultant

On larger value sales, with long lead times this is the ideal sales person. They are well suited to providing the customer with the information they require to make the decision. With an above average attention detail and they can sometimes be considered aggressive and usually are well educated. Their strength is their ability to build relationships. They are motivated by the prestige associated with winning sales and also large commission cheques.

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3. Relationship

The relationship sales person focuses on building long term relationships, they make great Account Managers but aren't always as hungry as the Hunter/Closer. They take longer to build a pipeline and may not see the urgency of monthly sales targets. These people often build solid relationships with clients and will often take clients when they leave your employ to work for your competitor.

4. Transactional

This type of sales person works on opportunities that require little personal involvement, they may be considered more as order takers. They are usually not paid on commission basis and enjoy the knowledge they will be paid even if the order is not received.

If your company is in an aggressive growth phase perhaps it may be advisable to employ a greater number of hunter/closer personas rather than relationship builders?

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Case Study

I recently worked with a company that were embarking on an aggressive growth plan that required a large increase in new customers. Their existing sales team of 10 had been with them for quite some time, they were used to working with the customers and servicing their needs rather than looking for new opportunities.

The sales team weren't delivering the new clients so I asked the Managing Director if he thought the sales team would be able to deliver the required results and suggested we do some personality testing with the Myers Briggs tool. As expected only one of the team of 10 was a hunter, the remaining 9 were all relationship builders and some changes would need to occur before the company would be able to meet their desired growth target.

They hired a highly trained and professional Sales Manager and made some changes to structure and the team were finally able to deliver the sales targets.

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Rewards

Most sales people operate more effectively under a reward system. How are you rewarding the sales team? Are they only rewarded for profitable sales growth? There is no point making sales if they aren't profitable or delivery times are unrealistic and may impact other, high value clients.

Taking some time to review your compensation model with an eye on what will engage individuals more effectively is recommended. We have seen some effective sales incentives that leverage the competitive nature of the sales team over a period of time (usually quarterly) to win a prize.

Note: ALL incentives and remuneration should be in line with profit margins and not exceed or cost the business more than the added activity brings in.

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Not all sales are created equal

Consider putting a focus on selling the more profitable products, these may be harder to sell but if they attract a higher contribution that could be all that is needed to increase profitability. We also believe that Sales teams should be focusing on jobs with the highest dollar gross profit margin contribution.

Selling a high volume of products at very low margins often ties up your operational and admin resources that may be better spent producing more profitable goods which achieve the same financial outcome for the business without the extra liability and stress.

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Marketing & Branding

Is your organisation placing enough emphasis on marketing and branding? This can be an overlooked area in a manufacturing business but the one area that can effectively impact revenue and business value.

To clarify the difference between the two. Marketing is what you do and Branding is who you are. Marketing is actively promoting a product or service in an effort to generate sales leads. Branding on the other hand can be harder to define. Put simply, your brand is what people believe about your product or service. Your brand it often the reason people buy from you or will pay a premium for a product. Just think of some of the world's most well known luxury brands and what they convey, they are often 10 times the price of similar products, yet consumers are happy to pay the extra. Marketing is tactical and Branding is strategic and that's why it is usually a CEO responsibility.

If your marketing and branding are working in harmony they should be feeding the rest of the business. Providing insights into what your customers are looking for and how products could be improved to meet market needs. Your Marketing team should have identified the high gross dollar margin products and be placing emphasis on promotion of these products to ensure profitability.

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Promoting the right products

Every organisation needs a marketing plan, it should be aligned with your overall business plan. This document is the road map that outlines how you will achieve both long and short term business goals. It should be well thought out and look to identify and sell the products with highest gross margins. At a minimum your marketing plan should list the sales revenue required for the coming year and outline the tactics that will be undertaken in order to achieve the targets.

Continual improvement

The most effective marketing plans gather metrics from previous years in order to determine the tactics that have delivered the best results so they can be repeated. We recommend a monthly marketing dashboard is developed so at a glance senior management can get the pulse for all marketing activity and easily identify any areas of concern.

By regularly tracking the quantitative effectiveness of your marketing you can ensure you are maximising marketing spend.

If you are not tracking the lead source for every new enquiry (either via website or telephone) this needs to be fixed today.

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Strategic Competitive Advantage

Can everyone in your service and sales team articulate your strategic competitive advantage (SCA)? Your SCA will outline why customers should buy from you instead of your competitors?

It's vital you are able to communicate the differentiating points, because when all things seem equal, customers will buy on price and that erode profit margins.

I always suggest to clients that they work as a team to articulate the SCA, once agreement is reached then staff performance measures need to be aligned with it.

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Pricing

Key to increasing profitability is an understanding of which products are more profitable. Take the time to explore your pricing model in order to understand gross margin dollars. Once you have this information it will be easier to decide which products to sell and market. We also recommend reviewing the market to ensure your products are priced correctly. Often a 2% increase won't impact sales but will assist profitability.

We find performing a "Glenday Sieve" can separate products into groups and usually pinpoint one product or a product group that is generating around 50% of sales volume for a business.

Tracking ROI (Return On Investment).

Are you tracking the return on investment from your Marketing Budget? Can the Marketing Team easily demonstrate which campaigns have generated the most sales? Always look past the number of leads generated to ensure you understand how many of those leads converted to sales. A campaign that generates a high volume of leads that don't convert to a sale isn't as powerful as one campaign that generates a low volume of leads but delivers 5 high value sales. If your organisation doesn't have systems in place to track this information then make a priority to implement this in the next few months.

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Customers

Clients are the lifeblood of any business, you know the importance of repeat business and keeping your customers satisfied. Is your business meeting your key customer metrics? How about on-time delivery, response times and quality?

When was the last time your manufacturing team visited your major clients?

How long since you have surveyed your customers? This is the most effective way to track performance and provide customers with a formal way to provide feedback and highlight areas for improvement.

Remember, they say it cost 7 times more to get a new customer than it does to keep an existing customer happy, so let's make your customers a priority.

How much of your business is coming from new clients each month? We usually aim for at least 25% of sales coming from new business. This is a strong indicator of the pulse of any business. If an organisation is innovating and growing they should be continually sourcing new customers.

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About the author

Ray Edwards

Corporate Partners

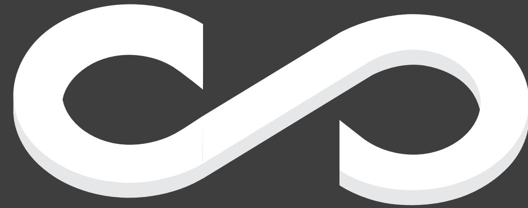
Ray Edwards is a recognised leader in business transformation. Since forming Corporate Partners in 2002, he has worked with some of Australia's most recognisable brands to transform their business. Before starting Corporate Partners, Ray held General Manager and other senior roles at Amcor and its subsidiary businesses for more than 13 years. Ray has a thorough knowledge of business management, leadership and the global best practices that ensure success.

Ray has helped his clients to save millions of dollars and increase profitability using his pragmatic approach to business transformation. Ray is passionate about helping Australian manufacturers to become more competitive.

Ray works closely with his clients to implement the changes required for their business transformation program; his knowledge is not only strategic but tactical too. The Corporate Partners approach engages everyone from Senior Management to factory floor staff to understand the change management issues and then ensure that the business can realise the impressive results that Lean Manufacturing implementations deliver. Ray is able to draw on his extensive leadership experience to work through the people issues that can affect change in any business; he understands that Human Capital is vital to the success of a business. Ray also recognises that the success of any project is measured on the bottom line, yet his approach is not about cost cutting, but about driving efficiency and eliminating waste.

Ray and his team of experts at Corporate Partners provide the following services:

- Business improvement and turn around
- Implementation of Lean Manufacturing processes
- Leadership development
- Business diagnostics
- Delivery of Certificate III, Certificate IV and Diploma qualifications in Competitive Systems and Practices



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