7 PROVEN STEPS FOR MANUFACTURERS TO IMPROVE PROFITABILITY AND CASH FLOW

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7 PROVEN STEPS NECESSARY FOR MANUFACTURERS TO IMPROVE PROFITABILITY AND CASH FLOW

If there is one thing that is certain in the last few years, constraints affecting business have increased in magnitude and are proving a challenging environment to the financial health of manufacturing companies.

In a study by ITR Economics, which has a proven track record in forecast accuracy percentage in assumptions related to future activities, constraints will be continuing through the next few years and provide a very demanding hurdle to operational success.

While we thought the last few years were temporary and challenges were close to discontinuance, unfortunately that is not the case and the last few years only served as the beginning of a longer-term matter.

In the realm of manufacturing, optimizing profitability and effectively managing cash flow are paramount for sustained success and growth. Specific strategies tailored to manufacturing companies can enhance financial health and operational efficiency. This ebook is meant to provide actions that are necessary to achieve financial success by placing focus on improving financial profitability and increasing cash flow from the operation.

Taking action surrounding these proven steps will result in stronger financial performance. Each manufacturer can and should implement not one but execute action on all these steps as necessary actions to achieve success.

What follows are the seven proven steps for future financial prosperity to your manufacturing operation. I want you to know that I am here to assist you in these critical steps to achievement.

STEP #01

Making business profitable by reducing costs, utilizing cost management, and increasing revenue through growth and sales price

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To make the business more profitable, manufacturing companies focus on reducing costs through the implementation of lean manufacturing principles, advanced cost management techniques, and strategic revenue growth initiatives such as product innovation and market expansion.

Reducing manufacturing costs can be approached in a variety of ways. A focus on procurement is essential as leveraging purchases across multiple vendors to identify low-cost suppliers is critical. In addition, a focus on product substitution needs to occur as moderate changes to product composition can have a favorable impact on production spend.

It is critical to focus resources on the procurement of goods and services. As inflation is not anticipated to decrease to the levels seen historically for a longer than anticipated time, this evaluation should be done regularly.

Cost management processes require the creation of regular reporting and analysis to be effective in identifying action necessary in association with costs. Establishing an estimated cost structure and reviewing actual performance can identify elements that were previously unknown and allow for change that results in improved profitability.

Creating the appropriate environment will vary on the type of manufacturing process at your location but planning and evaluation at the onset can create an optimal model to measure performance.

A focus on costs is necessary in increasing profitability but revenue generation is also a primary driver in achieving financial success. Revenue generation is based on three simple factors: unit growth, increasing sales pricing, and new product generation.

Although there are three simple factors, there is boundless opportunity with these options that need consideration. Awareness of the market is the single biggest driver. If you can understand this element, it is critical in addressing opportunities and negotiating with the customer base.

It is very likely that revenue growth will occur as a result of efforts and a combination of each factor in achieving opportunity. In my role as President of the final operation I was responsible, we increased sales revenue by $251 million over the 7-year historical average and we did this through commercial strategy, pricing negotiation and a collaborative leadership practice. It can be done!

STEP #02

Increase cash flow through stronger financial performance, reductions in inventory and accounts receivable and improving accounts payable position

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It is very likely you have heard the phrase "Cash is King". That is a phrase all manufacturers should consider the Golden Rule in business as it provides the greatest opportunity for financial success and allows for the company to consider growth opportunities that require additional capital outlay.

So how do you increase cash flow? Well, it is a combination of a few factors that include financial performance, reductions in assets and increases in liabilities.

Each of these factors has a myriad of options to achieve what is needed to result in improved cash flow.

Financial performance is a factor that will be discussed in a few of these steps, so this won't be focused on at this point. It can have a significant effect on cash flow but reducing a key asset such as inventory or accounts receivable can have an even bigger impact on cash flow so we will focus on those elements.

Focus on controlling assets is critical to the success of cash flow to manufacturing operations. Although assets are considered a good thing or "friendly", they require cash to possess and too much of a good thing can turn into a bad thing!

Several years ago, I led an operation and I created a model to optimize inventory whereby we used forecasted sales demand and established inventory targets to meet those forecasts. The result was a $15 million decrease in inventory that resulted in stronger cash flow to the business.

Establishing objectives and goals and utilizing forecasting can develop optimal inventory levels to successfully support operations.

There are strategies that can be applied to accounts receivable to increase collectability. This can involve terms, discounts or consignment arrangements that improve collectability.

The most important aspect is to establish what are the right elements and exercising the necessary due diligence to maintain the activity.

Working with suppliers and extending terms of payment is very important. Given the nature of the marketplace, this can be achieved if effort is exerted into the exercise.

STEP

#03

Address any employee crisis that is due to turnover, shortage or retention

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Employee supply was very impacted during COVID and continues into the present. Studies have shown that the adjustments in sourcing labor through flexible time and remote work has created a paradigm shift that is affecting the ability to adequately promote and improve an employee base at your manufacturing location. This, in addition to an ageing workforce, will likely continue for several years.

It is very important that you create a culture and environment that positively impacts employees. Their feeling of appreciation and belonging can go a long way to retaining their employment with your manufacturing location.

Compensation is a definite factor in the retention of employees. The implementation of marketing criteria of like responsibilities as those that exist in your organization can define appropriate salary levels or create ranges for employees and retention for longer term employment.

Another significant factor is an open environment that fosters two-way dialogue between the employee and the employer. The opportunity to be listened to by your employer is significant to the psyche of the employee.

Lastly, employee retention programs need to be established and monitored. The implementation of exit interviews for departing employees allows for the company to make changes necessary to retain great talent.

STEP

#04

Improving business operating efficiencies to drive profitability

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Although maintaining employee staffing can go a long way in allowing for steady operations, improvements in operating efficiencies allow for the opportunity to "do more with less".

Depending on the production that occurs at your manufacturing location, the opportunities to promote operating efficiency can vary. The first element that should be considered is an evaluation of machine operating efficiency.

By developing standards and then measuring performance to standard, this is important to understand overall efficiency and then to evaluate steps that should be taken to improve production. This can be highly valuable.

Operational efficiency can also be improved by developing an improved plant layout that drives machine efficiency by utilizing improved production flow. The less movement of product without production associated to the product results in higher yield in the operation and better results.

As labor is always an element to production, utilization of standards and regular time studies provides great feedback on performance to standard. This allows for specific information to be utilized by supervisory staff to improve efficiency with operating staff.

Analysis of yield loss and waste management are important elements to assist in evaluating production efficiency. Yield loss directly indicates utilization of machine and employee and allows information for manufacturing change to improve results.

Managing waste is a direct impact to the financial results but also reverberates with utilization of man and machine.

In a business that I led, we had significant seasonality with business and each manufacturing run was project based and would result in a new manufacturing activity on the next project. In addition, machinery could and would be moved within the plant as projects occurred. In a relatively short period of time, we were able to reduce several hundred thousand dollars by improving operating efficiency by using the standards mentioned previously.

This is an element of any operation that has a vast number of opportunities that can be addressed through analysis of manufacturing as it relates to machinery and measuring employee engagement. These results can be vastly impactful to operating results.

STEP #05

Producing accurate financial records, measuring financial performance, and determining what are the key metrics and reports that should be used

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Preparation and creation of financial records such as income statements, balance sheets and statements of cash flow can seem pretty routine, but it is the accuracy of the information and what is done with the data that determines the benefits of the information.

By developing good financial data, on a regular basis, and using this data to create key metrics to measure success, this can result in great intel to drive financial improvement.

The first critical step is to have proper creation of routine financial processes to properly and timely create accurate financial information. For the information to be accurate, a consistent and regular review must occur to identify areas for improvement, but, most importantly, create data that is measuring the key metrics for the business to measure success.

Key metrics can vary and depend greatly on the manufacturing that occurs at your location. There are always great financial metrics such as return on investment, EBIT and gross profit margin, but there are others that would be insightful in understanding the true performance of the business. Some of these include return on capital employed, working capital as a percentage of sales, operating cash flow, inventory turnover, and burn rate. There are many others, but an evaluation should occur with the business to understand and measure ones that are adequate for the business.

As I started my career as a CPA and a Controller, my eventual roles as President of various businesses allowed me the opportunity to consistently evaluate financial performance with our Controller. This was helpful for me to better understand the activities surrounding the business and lead to stronger financial results.

During my leadership, this resulted in an annual earnings record for a business that we had for twenty years, in addition to millions of dollars of financial improvement that resulted in consistently beating the budgeted expectations of the operations responsible. You can do this!

STEP

#06

Improvements in supply chain management to drive optimal lead times and management of production

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If there was a key driver that displayed the impact that disruption in supply chain management could have, it occurred during the COVID pandemic. As a nation, we witnessed severe disruption in the timely flow of production from producer to consumer through the various steps in the overall manufacturing process. Even with employees returning to work, the disruption was still visible for a significant amount of time.

This element of disruption has not been lost on producers as there is greater focus on achieving standard lead times and lack of delays to the manufacture of product. But this does require a systematic measurement, evaluation, and review of opportunity.

The first step is a reliable supplier base that entails supplier lead time measurement and strong logistics. These two attributes may need to be independently managed and monitored.

Consistent evaluation of suppliers should occur and there should be no sole sourcing to prevent supply chain shortages.

As it relates to logistics, a pool or collection of different logistic services should be utilized, and these should be used to independently bid on shipments to the location. A system of monitoring the loads should be implemented so that carriers can be graded.

In the first business I led, we had a bidding system for each load and found that we saved approximately $300,000 per year by utilizing this process rather than using company owned vehicles.

Improvement in internal production times will be crucial to optimizing the supply chain and this can be aided in the efforts related to improving operational efficiencies that were previously discussed. Without improvement in this area, all gains on external efforts will be negated.

Working with the customers to understand defined lead times will be extremely helpful to improve internal production lead times and use of external logistic carriers to consistently attain 100% on time shipments and deliveries. Communication and monitoring of customer expectations will be vital.

Management of the supply chain to operate near perfection will be an ongoing effort that has been merely exacerbated by the occurrence of COVID. As COVID has diminished, this is still an area that requires consistent effort.

STEP

#07

Macroeconomic influence of rising inflation and interest rates effects on spending and borrowing opportunities

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Macroeconomic influence of rising inflation and interest rates effects on spending and borrowing opportunities

According to the US Inflation Calculator, the inflation rate average for the twenty years from 2001 to 2020 was 2.06. This increased to an average of 5.6 from 2021 to 2023 or an increase of 273%. That is a very significant increase and something we haven't seen in decades!

Based on analysis by ITR Economics, inflation will likely remain elevated for a period of time, and we can attest by our own personal spending.

In addition, home mortgage rates are an indicator of overall borrowing rates and the rates seen in 2023 had not been seen in over 20 years prior to 2023. According to ITR Economics, the opinion is that these rates will decrease but not to the levels we saw in the 2012 to 2021 timeframe for a few to several years.

This requires manufacturers to be diligent in monitoring spending and to practice strategic borrowing principles. As has already been noted with efforts towards effective procurement and monitoring supplier management, spending is an element that will require consistent reporting and proper action.

Although you may not be able to decrease levels of spending to the same levels as several years ago, there are effective means to reduce this spending to mitigate some of the rising costs occurring.

As it relates to borrowing, this is attacked in a couple of ways. First, due diligence needs to occur in monitoring all capital expenditures. This means careful analysis of budgetary spending to mitigate budget overages. There also must be a credible analysis of the return performed as unacceptable returns cannot be considered.

Second, there are ways to work with financial institutions to lower effective interest rates that require a keen eye on balance sheet reporting and implementing strategies that had not been considered previously.

This element is a critical scope of work as the monetary value can be significant. There is opportunity though through effort and monitoring.

Conclusion

Your manufacturing operation is 100% capable of doing the above steps. Each one is extremely possible.

In the approximate 19 years that I held roles of Controller and President of three different operations that generated between $30 million and $1 billion in annual revenue, we were able to maximize profitability through several different strategies. This resulted in millions of dollars of additional income to the operations. We can do this!

Through the implementation of these tailored strategies, manufacturing companies can optimize profitability, strengthen cash flow, and position themselves for long-term success and resilience in a competitive marketplace.

I leave it to you to strongly consider my assistance in this journey to improve your financial position. Our collaboration and effort will attain financial benefit that will be valued, at minimum, between $50,000 and $100,000 annually with the proper evaluation and execution.

YOU CAN BOOK YOUR FREE CONSULTING SESSION WITH ME HERE

On this call, I will discuss the relative items and we can converse about potential options and what they can mean to you.

I look forward to hearing from you and beginning this opportunity with you!

About the Author

REED HOAGLAND

as experienced an extensive career at a publicly traded manufacturing organization that commenced in March 1994 and concluded in February 2024. During that time, Reed served as a Manager of Internal Audit, a Wire Group Controller, and President of three different manufacturing operations that ranged in revenue value of $30 million to $1 billion, annually.

During his career with the manufacturer, Reed served critical roles around financial reporting oversight of businesses totaling several hundred million dollars in annual revenue, leading and coaching strategic plans across multiple businesses, negotiating sales agreements, managing heavy manufacturing operations, and leading businesses through significant levels of restructuring and change management. Through these efforts, businesses saw multi-million dollar income improvements by way of organizational change, process improvements, strategic planning, and various improvements in manufacturing efforts.

Reed separated from the company to resume the career he originally started after graduating with a degree in Accounting from Missouri Southern State University where he received an academic scholarship. The first part of his career was working for a large Midwest CPA firm performing audits of manufacturing locations. After a brief career in public accounting, Reed obtained his Certified Public Accountant license in addition to his Certified Management Accountant license, which provided great background for success in a Controller role.

Reed has served on multiple board of director positions that included President and Treasurer.

His biggest reward or accomplishment has been taking upon a challenge that requires careful examination and evaluation and proceeding to execute action to achieve success on those respective projects. Each operation under his leadership has made significant improvement in manufacturing processes and financial results.

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