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Found Gold: Process Improvements Lead to Increased Cash Flow at Two New Jersey Distributors

by Anthony Zecca, CPA, Partner

CFOs and controllers are challenged every day to uncover new ways to help their businesses improve profitability and cash flow and be more competitive. While many companies have reduced staff, often these reductions were forced by the down economy, rather than achieved by permanently changing the internal business processes to allow the company to operate effectively and efficiently while utilizing fewer resources.

By implementing lean business concepts, Cohn Consulting Group's (CCG) Performance Consulting team, lead by John Macrae, a Lean Six Sigma Green Belt, has helped its clients eliminate waste in their business processes and redefine the way work gets done. This allows its clients to operate with a lower cost structure regardless of the economy's fluctuations.

Creating a Dashboard

Consider this example:

A beverage distributor had experienced significant growth as a result of a substantial investment in developing its brands and its considerable focus on strong customer service. Despite the growth, the distributor's margins were under pressure as a result of manufacturers' efforts to improve their own profitability by pushing more costs, which they had previously absorbed, down on the distributor. During the growth spurt, margins also deteriorated as the company lost some of its control over several of its business processes, which resulted in higher inventory levels and increased breakage and returns.

Using data analysis tools from Six Sigma, a methodology that utilizes data and statistical analysis to measure and improve a company's operational performance, practices and systems, CCG helped its client better understand what its data was saying about the actual performance of the processes contributing to increased breakage and returns, as well as the capability of those processes if they were improved. While the company recognized that, in a perfect world, breakage and returns would not be acceptable at any level, it was understood that a zero-defect target from the start would not be realistic. Therefore, the initial objective was to establish reasonable breakage and returns targets that could be achieved based both on past performance, and process improvements that could be implemented without changes to the external environment.

Cross-functional teams from sales, warehousing, delivery, accounting, and IT were organized and trained on the basic tools and technique of Lean to enable them to identify the issues that were contributing to the deteriorating effectiveness and efficiency of the key business processes. The teams identified the root causes for the increase in breakage and returns and developed solutions for reducing them and ultimately improving process performance. The company had previously reduced staff to address the decrease in profitability; management's initial thought, in light of the increased breakage and returns rate, was to rehire the staff in order to help address the issue. Through the work CCG performed with this internal team, it helped the distributor's management team understand how to improve its business processes to accommodate the existing level of business, regardless of decreased staff.

Lean business concepts help companies eliminate waste in their business processes and redefine the way work gets done, enabling them to operate with a lower cost structure regardless of the economy's fluctuations.

Recommendations were implemented and CCG worked with the teams to develop process performance metrics to measure the improvements' effect and to ensure the processes remained in control. In order to ensure a focus on constant improvement and continually drive for lower levels of breakage and returns, the company is implementing business intelligence (BI or dashboard) technology. This technology allows the distributor to pull performance data from several dissimilar systems—including its accounting system, a separate sales management system, and offline spreadsheets—into one easy-to-use, point-and-click dashboard. The dashboard provides constant communication regarding process performance and allows for timely decision-making to correct issues if process performance slips below the new standard.

Six months into the implementation, average monthly breakage was reduced by approximately 40 percent, which has contributed to a dramatic improvement in the company's profitability. In addition, the company has reduced inventory levels and therefore the working capital it needs to support its business as a result of reducing its inventory levels and the cushion it needed to maintain in order to absorb the fluctuations caused by the prior levels of breakage and returns.

Improving Effectiveness and Efficiency Through BI

Another manufacturing client hired CCG to help improve the effectiveness and efficiency of its accounting and finance function and its inventory costing methodology. Its inventory costing process was inaccurate and required a significant amount of manual adjustment at month-end. While the company was profitable, it experienced increasing inventory levels and slower inventory turns, despite modest growth. The company had a significant amount of cash tied up in working capital and had several more capital projects on the board that required funding. Despite this significant investment in inventory, no one really "owned" the inventory management or purchasing process. The company's accounting and finance department was more concerned with the accuracy of the inventory accounting than with helping the company better manage the investment in inventory.

CCG worked with management to identify historical target inventory levels. Each inventory turnover was equal to more than $1 million, and the initial target was a two-time improvement in inventory turns for a more than $2 million cash impact, with a four-time improvement or $4 million target by year-end.

A team from accounting and finance and IT was gathered to evaluate and improve the inventory costing process and to modify the costing methodology in its accounting system. Because the company lacked visibility into its inventory performance, CCG recommended a business intelligence solution to allow accounting and finance to track inventory performance at the individual item level.

The company had a disconnected planning process. As sales developed a top-line sales forecast, accounting and finance developed an expense budget, but the two were not connected, and everything was developed in Excel spreadsheets. In addition, the purchasing process was disconnected and reactive and lacked the ability to plan based on sales forecasts. CCG worked with the company and made recommendations for improving its budgeting, planning and forecasting processes including improvements to the methodology and the ability to link the sales path, from individual customer forecasts all the way through purchasing.

While CCG's recommendations focused first on developing and improving a manual process, the company is now in the process of evaluating the recommended budgeting, planning, and forecasting tool, which would automate the new manual process. The benefits of such a tool include the elimination of multiple, disconnected Excel spreadsheets and the issues associated with controlling their content and the integrity of formulas, roll-ups, and version control. This investment in budgeting, forecasting, and planning technology and the BI solution utilized were easily funded with a fraction of the cash generated by the reduction in inventory.

Developing better forecasting and planning processes and systems has helped clients reduce their inventory position and, subsequently, increase their cash flow. Freeing up millions of dollars through inventory improvements, especially in this economy, is akin to found gold. ■

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