

# Financial Worries?

## Take Action with Lean NOW!

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By Jean Cunningham

Many are currently quaking in their boots about the viability of their company during this confusing and complex global economic downturn. All of us are worried about cash since it is the grease that makes our business engine run smoothly, and now more than ever, we need to maximize its availability and use it prudently.

Further, since applying lean thinking to processes often conserves cash, you probably should ask, "How can our lean efforts help us RIGHT NOW?" While lean at a macro level is a long term culture transformation, there are focused actions to consider when trying to free up cash.

This article provides a few suggestions on how to conserve cash or use it very wisely to maintain your business engine so it does not sputter or even seize up and stop!

### Only Make What You Can Sell

*Scrutinize every production order to ensure it is for items that are needed based on true customer demand.* Ensure you are not producing items based on production orders created by the MRP system using potentially outdated forecasts.

*Reduce your batch sizes to match the demand rate.* Often batch sizes are set to reduce the number of set ups based on assumptions that the equipment needs to be kept running all the time, or based on maximum internal capacity. Unfortunately demand is usually lower than capacity, so you should decrease your batch sizes and increase your set ups so that you are not making excess units based on some outdated batch size calculation.

*Talk to your customers to establish demand.* Ensure that their needs and demands are not changing. They are in the same economy, so you do not want to take outdated forecasts and use them to consume your resources. Ensure there is good visibility to your customers real demand rate where ever and as often as possible.

### Why worry about Cash?

Without cash you cannot invest in materials, people, and facilities.

Without cash you cannot offer credit terms to our customers.

Cash comes from either the margin on your products and services, from investors, or from banks.

Normal use of banks and investors is out of kilter because of the financial industry meltdown.

So, you need to conserve cash so that you can pay ongoing costs in case demand drops.

You need to conserve cash so that you maintain flexibility if your normal bank loans are not available or have higher interest costs.

And, if you are in a strong company, having cash reserves allow you to make acquisitions when prices are very low to increase our strategic footprint.

## Buy Only What You Need

*Rethink your strategy of finding low cost materials or service suppliers.* Look to local suppliers who can offer smaller units more frequently. New customers are also of great value to suppliers right now, so you might also get some very attractive pricing. Even if you pay more for smaller volumes delivered more frequently, it can significantly improve your cash flow.

*Implement external kanban.* This is the practice of re-ordering based on the actual consumption of materials rather than forecasted usage. Forecast usage ordering in nearly every case will increase your purchase of raw materials. Create “pull” (lean thinking) with your suppliers!

## Root out Work In Process Excess

The first place inventory drops with lean thinking is when you link your production areas to create flow. If you have done this, then you have already realized this tremendous benefit. But if you are like many, you still have opportunity here. One quick way to ensure you do not have unintended WIP is to take three steps:

- *Ensure you never start production of an item unless you have all the materials in house to complete the item.* Far too frequently, production stops because of lack of the right materials at the right place at the right time. When this happens, production stops.....wasting all the efforts that have gone before.
- *Ensure your equipment is ready to go when you are. Start some Total Productive Maintenance activities.* The second area of unintended WIP is when a item is started and then the equipment breaks down, is not ready to produce, or has no people assigned to the job. Again, when this happens, production stops. And, the cash stops flowing too.
- *Reduce batch size until you get your equipment near capacity.* Any batch larger than one that does not make equipment or personnel over capacity is both an increase in material consumption and an increase in lead time. Most traditional thinking does not understand this point. So, try it out now if your demand is low....a “free lesson” in lean.

### Why does standard cost drive overproduction?

Standards are determined by establishing the capacity of each machine or operation in units of time. Then a cost is assigned to that unit of time. The cost is usually divided into two categories: labor and overhead.

A rate is created for each machine which is the total expected spending for labor and for overhead divided by units of time for each machine or operation.

So if the machine or operation produces all the time, all the costs are absorbed, and there is no variance. If more is produced there is a positive variance. If less is produced there is a negative variance.

No one wants to see negative variances because they think negative means bad or wrong.

So to avoid bad numbers, workers and supervisors try to keep the machines running and make as much as possible regardless of demand.

It's just human nature.

## Collect the Money

A tried and true method to help the cash crunch is to collect the money owed to you for products and services already provided. The normal method is to call up the customers and beg them to pay. This is often a pathetic activity when you consider that the number one reason that customers do not pay is because there is a defect in the invoice that is sent to the customer. Over and over again, we find that when an improvement event (kaizen) is focused on the invoice to cash process, we identify significant waste and gaps in the process that keeps the cash in the customer hand, and not in yours. Launch a kaizen event now on this topic.

## Measure the Right Stuff

Now more than ever, it is imperative to ensure you have the right measurements. If you use standard cost accounting you will not have the information you need to manage the business and cash flow of the company. Standard cost accounting thinking has no focus on the customer and thereby will cause you to over produce in nearly every circumstance.

In fact if you do the actions listed above, standard cost measures will actively tell the organization that they are the WRONG actions to do. Immediately switch your focus to what you ship and not what you produce. Look at your actual spending categories: wages, benefits, utilities, scrap, supplies, etc rather than your performance to standard cost measures. Remember, these measures are set to consume all your capacity, and not to control your cash.

Paying people to produce excess product costs more than paying people to produce nothing. Use any idle time to clean, train, implement improvements to process, improve workplace organization, and make progress on important initiatives that are behind schedule.

You and your organization cannot afford to overproduce.

Jean Cunningham is the founder of Jean Cunningham Consulting which provides lean improvement planning, coaching, facilitation, and education. Please contact us today at [www.jeancunninghamconsulting.com](http://www.jeancunninghamconsulting.com) for help in any of these areas.