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Record-Breaking Sales – Barely Breaking Even

By Miles Free, Director of Technology Services mfree@pmpa.org

I was talking the other day with the chief executive of a shop when he made the following comment, "We have record-breaking sales, yet we're barely breaking even. We ran the numbers, and on almost every line item, our costs are up a tenth of a percent or so. That doesn't sound like much, but at the end of our study, those one-tenths added up to almost 7 percent. The Fed and Greenspan missed it. Inflation is alive and well. I can show it to you in my books."

He was right. He was being "tenth-of-a-percented" to death. But responsibility for the situation does not belong solely to our suppliers. Most companies find themselves between the pincers with a customer base demanding ever-decreasing prices on one side and a supply base with ever-escalating costs on the other. What's a company to do?

Customer base. It's certainly no news that our customers expect ever-decreasing prices for the products they buy. The global run-up and short supply of many raw materials was a wake-up call and reality check for many of the larger original equipment manufacturers. Those OEMs based their institutional performance and purchasing agent performance incentives on an ongoing annual reduction of 5 percent of purchased price from each of their suppliers.

However, to make that reduction target even more impossible to achieve, those companies' policies and purchasing programs actually add costs to their suppliers by reducing lot sizes, decreasing lead times and stringing out payments to the suppliers.

Reduced lot sizes make parts more expensive by increasing the percentage of setup time for each of the smaller number of parts produced. Decreasing lead times make spot purchases for materials, tools or supplies necessary usually at higher-than-budgeted prices. Perhaps premium freight is needed.

The downgrading of Ford and GM to junk bond status means that rather than pay exorbitant interest rates to

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the commercial paper markets, the big boys will surely be tapping the credit of their suppliers by extending payments to their vendors. Quick – what does an extra 30 days float by slow-paying save a company compared to borrowing at more than 14 percent interest in the bond market?

Supply base. Even Rip Van Winkle could tell you what has happened to raw material prices over the past 2 years. Anyone who drives knows that the price of gasoline is no longer "$0.339 a gallon." Electricity rates and energy costs might be only a few percent of your operational cost, but ours is a transformational industry. Without the application of ever-more expensive energy to make materials, there will be no parts to ship. Also, what area of the economy and our industry's supply base is not affected by increases in materials or energy costs?

What's a company to do? When the assault is coming from two directions, the first thing that has to be done is to guard the borders from which the assault is coming. Pat Buchanan never made it to the White House, but his call for border security rings true to all of us in this post-9/11 era. The same is true in our businesses.

Attention to our accounts receivable must be a daily task, or we could find that it is we who are underwriting the assault from our customer's side. Similarly, we must be disciplined about maintaining stable prices from our suppliers wherever possible. Where the global realities make that impossible, we must be responsible, and assure that our businesses are not hurt by these increases.

> *"We must make absolutely certain that our operations are in order and that we are continuously improving."*

The real lesson in this situation comes from a principle taught in metallurgy avoidance of tri-axial stresses. As long as the stresses are in a 2D field, the material maintains its integrity. But when the stresses are encountered in a tri-axial or 3D way, the material soon fails. Our most important job as managers is to prevent the third front from coming into play.

The third front. Our operations are the third front. If we are to survive the encroachment from either the customer or supplier side, we must make absolutely certain that our operations are in order and that they are continuously improving. That way, we can earn back possible losses on the other fronts.

Smaller lot sizes can be offset by reduced setup times. This also helps your company remain agile with shorter lead times. Avoiding waste throughout your operations is another area to be profitably engaged. Do you really need to have all of those supplies, tools, packing materials and methods?

Inside the four walls, floors and ceilings of our shops, everything we see (and most of what we don't see) had to be paid for. Why is it there? Should it still be there? What is on order that doesn't have to be?

There is not much we can do about customers that believe the globally lowest price, decreasing 5 percent per year is their birthright forever. There is not much we can do to lower the prices of raw materials needed to make our products. There is nothing significant we can do to lower the cost of oil and energy in today's global market.

However, the secret to our business success today and sustainability in the future lies with our ability to continuously improve our operations: reorganizing, requalifying, rethinking, reconsidering and reinventing the way we transform materials into parts.

That is why the chief executive I mentioned was so cheery as we discussed his plant reorganization. He knows what the issues are and he knows what his people can do about them. How about you?