The Manufacturing Leader

Perspectives for small and mid-size manufacturers

Personal Note:

From Rob Tracy

Welcome to Issue #3 of *The Manufacturing Leader* newsletter. This issue has six articles covering a broad spectrum of topics, ranging from marketing to supervisor development. Hopefully there is something for everyone.

If you like what you are reading, please feel free to pass this along and let the recipients know that they can have it emailed directly to them by going to https://robtracy.net/subscribe.

Thanks for taking the time to read this, and as always, please let me know if you have any feedback.

RJ Tracy

Recognize how you make money by exploring four customer types

By Rob Tracy

In a moment of frustration about lower-than-deserved profits, you may have uttered, "Let's just fire our unprofitable customers!" While that may be overkill, the thought process has merit. All customers are not the same, and preferential treatment to the highest-value customers is warranted. In the 1980s, Illinois Tool Works (ITW) introduced their 80/20 methodology, which explicitly calls for treating the 20% of customers who generate 80% of profits differently. It has been a critical component of their growth from a small machine shop in Chicago to a $14.1 billion diversified manufacturing company with a 24.1% operating margin.

The first step in this journey is to understand how much each customer contributes to profitability. If life were easy, you'd simply run a gross margin report and sort them in descending order. You'd draw a line on the sheet, and anyone below that line gets a significant price increase.

However, that approach would be a mistake. Gross margin is deeply flawed for this kind of analysis. The underlying issue is that standard cost systems don't accurately reflect each customer's real costs. This disconnect has two drivers:

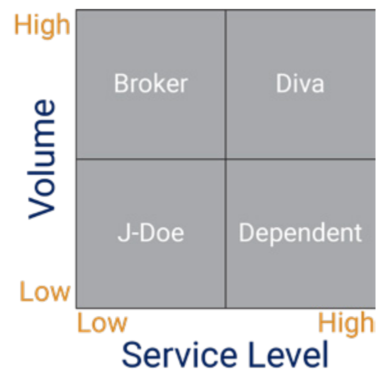
1. The method of applying overhead to products is somewhat arbitrary (labor hours or machine hours).
2. Many customer-driven costs hit the P&L below the gross margin line, and they become part of the general overhead structure and not assigned to a product.

Let's explore this further by defining four customer types, as illustrated in the chart in the next column.

The X-axis is the Service Level, and it indicates the amount of "add on" service a customer demands. Customers who rank high on Service Level may require services such as inventory stocking positions, compliance with bureaucratic quality systems, small lot sizes, participation on product development projects, and guaranteed annual price reductions. These aren't necessarily bad, but they aren't free either.

The other axis is Volume, indicating the amount of business that the customer does with you.

The combination of Service Level and Volume defines the four customer types: Diva, Dependent, J-Doe, and Broker.



In the rest of this article, we'll explore each customer type and how gross margin might inform, or misinform, our view of the customer's impact on profitability.

Diva:

Definition: A high-volume customer that demands high service levels

These are the customers that elicit a love-hate relationship. They demand more every year. The customer knows that they have power, and they are fully prepared to use it.

Gross margins tend to be overstated for Divas, making you think they create more profit than they do. The reason is that many of the services that Divas demand fall outside of the standard product cost. All of those extra services become part of the overhead,

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Management Operating Systems (MOS) Are NOT Great for Every Issue

By Mark Capaldini

Management Operating Systems, such as EOS®, Scaling Up®, and Rhythm®, are valuable and powerful tools that produce terrific results for many businesses. But they are not necessarily a good fit for every business or every situation. Like any powerful tool, these systems are most effective when used for the right jobs.

Great Fit for a MOS

Let's first review some issues that are a great fit for a MOS.

Communication – A single weekly meeting of the leadership team can save time and result in better, faster decisions. With discipline, it can also focus on problem-solving.

Alignment – Even in small companies, there is a need for clear and constant alignment on strategy and priorities. This is an emphasis for any MOS.

Focus – Clear focus on the company's strategy, markets, and target customers is foundational It will support consistency in decision-making at all levels. No distractions and detours.

Accountability – True accountability is a voluntary mindset, accepted and expected broadly by all individuals at all levels. Consistent and transparent accountability is fundamental to any MOS.

Teamwork – In day-to-day operations there are many small obstacles to teamwork. Any MOS will spotlight the need for – and results from – good teamwork.

Execution – Execution is simply getting stuff done, effectively, efficiently, and on time. It's the key value of any MOS. If it's your primary challenge, a MOS will help.

Not a Great Fit for a MOS

Now let's review some issues that are NOT a great fit for a MOS.

Strategic Moves – Significant strategic moves, such as the response to new competition, new technology, new markets, or major new products are not a fit for a MOS. Selecting the right strategic moves requires external resources, expertise, and perspectives. And they are not typically integrated into MOS tools.

Personnel Development – A common concept in operating systems is to be sure that the "right persons are in the right seats" on the leadership team. But they don't address how to develop staff so that they can grow into leadership roles. Or, just as critically, to expand the skills of the current leadership team members.

Wrong Leadership Team – If a leadership team is dysfunctional, doesn't include the right set of skills, or is uninterested in collaboration, no MOS will solve those problems. Any MOS will highlight skill gaps, poor cooperation, or underlying tensions. So problems will be amplified, not resolved.

High Conflict Situations – If there is high conflict among the owners or leaders of a business, the implementation of a MOS won't be successful. These systems assume a baseline of teamwork and collaboration, as well as tradeoff of personal or department priorities for the achievement of company goals. Such conflicts need to be resolved outside the MOS.

Weak Process Discipline – Any MOS requires a commitment to structured processes. These, include the weekly review of scorecard metrics, measureable progress toward quarterly goals, and quarterly evaluations. Half-hearted commitment to such discipline will cripple any MOS.

Loose Partnerships – Many partnerships, such as accounting firms, law firms, and other professional services firm are a loose confederation of independent revenue generators. Decision-making is often highly decentralized and not driven by a single firm-wide leadership team. This is not a great fit for any MOS.

Consider the above list before adopting any MOS. Or to resolving those that are not a great fit by utilizing tools and resources outside your MOS.

Mark Capaldini is President of Opportunity into Revenue (www.oppintorev.com). He offers a free two-page questionnaire, entitled "Optimizing for Any Management System." Request a copy by emailing him at mark.cap@oppintorev.com.

Read more from Mark at his blog at https://oppintorev.com/blog/

Six Key Components that will develop your Supervisors into Leaders

By Gayle Noakes

All too often when we realize our Supervisors need more skills, we sign them up for a training program and wipe our hands, thinking the job is done. The Supervisors probably do need to learn new skills, but there is so much more that needs to happen for the Supervisors to effectively use these skills back on the job.

There are six key components that all need to work together to create Supervisor Success.

Learning

Too many training sessions are still conducted with the attendees sitting and listening and looking at a Power Point presentation. Adults learn best through practical, hands-on activities, directly followed by applying the new skills back on the job and getting feedback on how they did. Supervisors need to learn from someone who knows manufacturing and can help them relate what they are learning to their real job in the manufacturing environment.

Coaching Environment

Your Supervisors will put the new skills and behaviors they learned in the learning sessions to use real time on the production floor. Supervisors need a leader/coach in the company that they can go to get advice, ask questions and even practice conversations they need to have with their employees, not only during the learning process but for the long term.

Sponsor

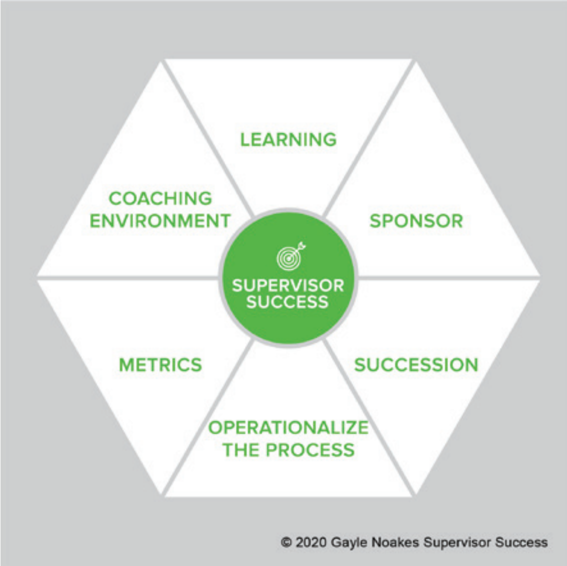
As initiatives come and go, one leader in the company needs to be the champion and make sure the development of the Supervisors and employees continue. This includes defining and measuring what will be different in the business when development continues consistently and intentionally, setting clear expectations for development and job performance, building development efforts into the annual budget and standing for development when short-term focus works to stop it.

Metrics

Supervisors are often measured on regular production metrics like production throughput. Do their metrics really match all of their job expectations, like training, coaching and developing the skills of their people? To reinforce leadership, the measures must reflect a larger business impact, such as, employee retention and internal employee promotions.

Succession

Development is a journey, not an event. Once Supervisors feel confident in their role, they need to be encouraged to develop others. They may need help on how to do this. They will need coaching on



how their role and skills need to change and evolve as they build the skills of their people.

Operationalize the Process

As with any manufacturing process, we need to document, audit and reinforce the successful process to sustain it over time.

How does your Supervisor Development program measure up?

To take a brief self-assessment, go to https://www.gaylenoakes.com/self-assessment Contact Gayle at gayle@gaylenoakes.com or 612-791-8981 to discuss your self-assessment results.

About the author: Gayle Noakes spent 20 years working in manufacturing companies. She now owns Gayle Noakes Supervisor Success, working with manufacturing companies to build the skills of their front-line Supervisors.

Practical Supply Chain Automation for Small Manufacturers

By Tim Allen

When you think about supply chain automation what often comes to mind are mega-corporations with expensive and complex robotics running people-less factories and warehouses with endless arrays of software and robots moving materials and churning out products. How can a small manufacturer possibly afford automation? The answer is they can, but with more practical and reasonably priced "mechanical" automation technologies that can be applied in the areas of materials handling and movement. One example of an effective mechanical automation smaller manufacturers can adopt is called "gravity flow racking".

What is gravity flow racking and how does it work?

Gravity flow racking systems use storage racks with metal rollers placed at downward angles to allow materials (parts or components) and products to "flow" using gravity. If you have ever taken a trip to the supermarket to buy your favorite beverage whether by the case or can you likely utilized a flow racking system. Most gravity flow racking will also let you adjust rack slot width to accommodate multiple size parts or products. Flow racking can be configured in a variety of lengths, shapes, and flow angles. Steeper roller angles are often needed for lighter materials. For heavier materials, shallower roller angles, metal stops, dividers, and spring latch systems can be combined to safely control flow.

How are gravity flow racks used?

Gravity flow racks can be used to feed materials and components directly into an assembly station thus reducing the time and effort required by the assembly employee to acquire and move parts or components. Gravity flow racks can also be used as an effective and simple way to move work in process from one assembly station to the next without requiring the operator

to physically lift and move product to the next operation station, reducing operator motion and improving safety. Gravity flow racking systems also accommodate good visual replenishment. By walking down the backside of the flow rack, it is easy to see which slots are empty or low requiring replenishment to keep assembly work moving.

A good way to determine probable areas for using gravity flow racking is to take a walk through your production/assembly operations looking for areas where employees

are repetitively moving, retrieving, lifting, twisting, and transferring materials. These areas can be probable points where gravity flow racking applications could be useful to reduce motion keeping production work flowing while improving safety.

Where to find Gravity Flow Racking

Gravity flow racking systems are abundant and come in a variety of configurations. Reasonably priced, used gravity flow racking in good condition can be picked up through a variety of secondary resellers. A quick internet search underused flow racking in your geographic area will provide a lengthy list of resellers.

Gravity flow racking is just one of the many automation solutions for material handling challenges. If you would like to discuss this or other options please feel free to call or email me.

About the author: Tim Allen is the VP of Management Consulting at Pragmatek and specializes in helping small and mid-size manufacturers improve business profitability. Contact: (214)-493-9111 tim.allen@pragmatek.com

How to Keep Your 2021 Pipeline Full Without Trade Shows

By Joe Sullivan

Symbolically, it'll feel good to leave 2020 in the rearview mirror.

But who knows what lies ahead in the new year?

- Will a vaccine prove effective, reinstating travel and in-person meetings?
- If so, how soon?
- What about trade shows? If they're not cancelled yet, we should assume they will be

So what to do then, in the absence of trade shows? Well, first of all, I encourage you to look at this as an opportunity.

I've consulted 100+ mid-sized manufacturers over the past few years and very few don't rely on trade shows. Heck, some spend $300K+ on single events – shipping equipment (and lots of people!) across the country, renting floor space, printing collateral, etc. And those are only the hard costs.

Although most have generally positive things to say about their trade show experiences, few have told me "we consistently source $500K or $5M or (fill in the blank) from these events".

More commonly, I hear, "We usually come home with a stack of business cards and might close a few deals. Not sure how many."

So here's my big question, headed into a year where from day one, you know you'll have to do biz dev differently...

What if you reallocated that budget to generating demand in a measurable way among 50% or 75% of the most important buying process influencers in your total addressable market?

Here's a simple framework for you:

STEP 1. Focus on your best type of customer

Identify your best, most profitable customers. Document that ideal customer profile – industry, role at company, geography, etc. Then document their buying triggers, pain points, personal goals and common questions. Get it all down in writing because you're about to put it to use!

STEP 2. Create a bank of amazing content specifically for them

There's so much knowledge stored in the brains of your Engineers, Sales professionals and Account Managers. Those who regularly interface with your best prospects and customers know them inside and out.

So tap into their brainpower and extract that knowledge for content that will attract, engage, nurture and open the door to sales conversations with those ideal buyers. Your content can come in many forms – from written word to a podcast to live webinars (that you can record and publish as on-demand video content).

STEP 3. Distribute. Distribute. Distribute.

If your audience doesn't know your content exists, they can't consume it. So we need to proactively go out there and target those Engineers, Plant Managers, CFOs and other individuals inside your target accounts and deliver your content directly to them.

Put a little media budget behind it and tell LinkedIn or Facebook (for example), "Show this three-minute video of my two subject matter experts talking about the total cost of ownership of X type of packaging machinery to Plant Mangers from the Food Manufacturing Space in the Midwest".

Combine this with smart SEO and email distribution playbooks, and now you've got a marketing strategy where you're:

- reaching the right people with content that matters to them
- positioning yourself as a thought leader in your space
- building trust through every little insight you deliver week after week

If you do all this right, believe me, the sales calls will follow.

THIS is what works today. Not print ads. Not brochures. Not direct mail. Not cold emails. And not trade shows (at least for now).

Joe Sullivan is a Cofounder of the industrial marketing agency Gorilla 76 and host of The Manufacturing Executive podcast. Visit gorilla76.com/learn for an ever-expanding collection of articles, videos, guides and tools to help midsized manufacturers identify, attract, engage and drive sales with ideal-fit customers. And listen to his show at themanufacturingexecutive.com.

Proactive Recruiting and Retention – building your people plan like you would your business plan

By Mary Nutting

I work with entrepreneurial businesses every day, and I'm continually impressed with their strategies and visions for growth. They are clear about their customers and how they'll compete, and they have solid ideas about where they'll want to invest in capital and equipment to fuel their growth. However, what I often see is that their plan for talent hasn't received this same attention.

Hiring and retaining the right talent for your organization can be every bit as difficult as winning new customers, and it deserves a solid plan. Here are some tips for developing your people plan.

Know the candidate market:

Understand the candidate market in your area, including availability, competition, and candidate expectations (both monetary and non-monetary). If you feel you are at a disadvantage to attract and retain the talent you need, you may have some heavy lifting to do to improve your position. Talk to prospective candidates and learn what is most important to them and then prioritize and invest in areas to improve.

Build a People Model:

Consider the ROI on filling a key role and how that right person will help you meet your goals and objectives. Merge your budget of projected growth with a pragmatic turnover rate. Be realistic about the number of people that you will lose each year due to resignations (more common with younger workers), seasonality or operational constraints, aging workforce and those approaching retirement.

Build your internal pipeline:

Build a culture where recruitment is everyone's job. Referral bonuses, and an internal applicant tracking system to build your own database of talent are must haves. You can't be too small to use these services and thankfully, there are new, low-cost platforms designed specifically for smaller companies.

Balance the desire to hire the perfect person vs lost opportunity costs:

It's about balance when making a selection decision. A wrong hire can be very harmful, but there is also a lost opportunity costs when a position is not filled. Develop a list of the business behaviors that are non-negotiable with all hires. Of course, this means that they absolutely have to fit your culture and values but also look at those key traits that align with your plan such as grit, determination, resiliency, being highly accountable, etc.

Invest in development:

Development is essential for employee retention and performance, and it makes good financial sense. You want to avoid the vicious cycle of claiming that it's not worth it to invest in training because the people are just going to leave anyway. That kind of thinking is a self-fulfilling prophecy. Build training and development into the plans for hiring so your people choose to stay because they see that you are investing in them and they feel valued.

Define the Moments That Matter for retention:

How do you retain your employees? Define the 'moments that matter' across the employee lifecycle. What is MOST important to YOUR people. This could include the interviewing and on-boarding processes, training and development, promotion opportunities, pay, recognition, alignment with the company vision, or community engagement. You won't be able to focus on all of them. What is most important to them? Ask your people. Listen to what they say.

Wrap-up:

There is a battle being waged for great people, and it has raised the hiring and retention of people to a strategic level. A comprehensive people plan will help to ensure that you have the talent that you need to achieve your goals.

About the Author: Mary Nutting is the Owner & President of CorTalent, a national recruitment and retention consulting firm. Mary helps growing companies find, select and retain top talent with an emphasis on culture and values fit. CorTalent's services include search, hourly recruitment support, talent assessments, and retention strategies. Mary can be reached at 952-270-5423 and mnutting@cortalent.com

Four Customer Types

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and then they get distributed to ALL customers. This accounting method makes Diva's profitability look strong at the expense of less-demanding customers.

Senior leaders must manage Divas strategically. They can be challenging, but they can also make a company better by forcing innovation and growth.

Dependent:

Definition: A low-volume customer that needs high levels of service

Dependents are a group of customers who want more add-on services than their recurring revenue might warrant. They may be a small company lacking internal resources or a product development team within a larger organization. In both cases, they are dependent on your technical expertise.

Like Divas, gross margin reports overstate Dependent profitability because most of the costs they drive happen outside of the product's production.

Leadership teams should evaluate Dependents carefully because they can drive considerable costs with no commensurate revenue. It may be advantageous to implement a practice of charging for engineering, design, and prototyping work for this customer type. At one company that I ran, we established a policy of "No Inventors."

J-Doe:

Definition: A customer that doesn't purchase much or need much support

J-Doe customers are somewhat nameless and unseen. They are a small customer, and they fly under the radar. Individually they don't have much of an impact on revenues, costs, or profits. However, when combined, their impact can be significant.

Given the low service needs of the J-Does, gross margins tend to be a reasonable approximation of customer profitability. This group should be reviewed occasionally, perhaps yearly, to ensure that margins continue to be healthy and internal costs haven't crept upwards.

Broker:

Definition: A customer that buys in high volumes but requires few add-on services.

The "Broker" is the final type of customer. They buy in volumes, and the price is the primary driver. The Broker has reasonable quality and delivery expectations.

A Broker's margins can look skinny. However, this can be misleading because the amount of overhead needed to support the Broker is often far less than that of customers requiring high service levels, like Divas.

When analyzing the impact of a Broker on profitability, it is helpful to look at the dollars that the customer contributes to the overall company profitability rather than a percentage. I usually use contribution margin dollars, which is the revenue minus the direct labor costs and materials. It is common to see that Broker customers contribute large dollars towards profitability, despite the low margin percentage.

One of the most significant opportunities that I see is for companies to win more Broker business. The perception of "not being able to compete" is often false self-talk driven by the standard costing system. If you have excess capacity, a few Broker customers can make a world of difference to the company's profitability.

Wrap-up

Managing various customers strategically can pay enormous dividends. All customers are not created equal, and they should not be treated as one homogenous group. One of the first steps to create a profit-driven customer strategy is to understand customer profitability at a deeper level. This requires looking beyond the typical gross margin report and understanding which customers are truly driving the company's costs. The analysis takes a little work, but it's a straightforward exercise, and it's likely easier than you may think. I'll cover this further in next month's issue.

If you'd like to get a clearer picture of customer profitability, please reach out to me. I'd love to help you get the insights you need to drive the profits you deserve.

About the author: Rob is a consultant that focuses on helping leaders of small and mid-size manufacturers to achieve their goals. He specializes in custom-tailored operating systems and strategic consulting. He can be reached at 651-398-9280 and rob@robtracy.net