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Measuring success with performance standards

Running your business by the numbers

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Business owners who decide to run their companies “by the numbers” don’t measure success on the basis of year-end revenue. They know revenue and profit should be monitored all year long and used in conjunction with indicators such as financial statistics, cost trend analysis, employee productivity / capacity utilization, and inventory controls. Only when data is tracked and measured can it be used to make educated decisions about a company’s future.

Most owners and managers working in the metal forming and fabricating industry would be happy to trade in their “firefighting” responsibilities for sufficient time to address day-to-day planning, not to mention long-term strategic planning—especially if they’d realize they can look at each measurable component of the company and track the company’s success daily versus monthly.

Unfortunately, many are locked in, because fighting fires always wins out as a priority. Yet the day will come when even those long-ignored strategic issues start their own fires, leading to an even greater lack of control or heightened competitive environment.

The Key Numbers

Every industry has key financial indicators that business owners have come to rely on for managing daily opera-

tions and planning future growth.

For the metal forming and fabricating industry, one key number is the scrap rate. If it’s too high, that signals potential problems in the manufacturing process, in the training of employees, or in scheduling of machinery repairs and maintenance.

Another key number is the target waste rate. As an example, raw steel waste in excess of a given percentage may necessitate examination of the various operational components in both the human and mechanical manufacturing processes. This may uncover problems in unexpected areas.

Management also can find key numbers in most operations—such as inventory control (raw materials, work-in-progress, finished goods, and obso-

lete), cans management, and capacity utilization—and in variable expenses, such as overtime. With this type of overall picture, managers can determine whether jobs are being bid properly, in terms of both pricing and delivery schedules.

Each company within this industry relies on different combinations of numbers, depending on the nature of its business. Identifying these numbers and being able to rely on them begins with analyzing key areas of produc-

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tivity within the company. For example, which focal activities seem most significant to the company's success? Once management has identified these hot spots, it can examine where specific measurements can be taken.

Another way to analyze business success is through profitability increases in both real and percentage terms. Once a company determines its revenue items and the percentage of profitability tied to each, it then can decide whether it generates reasonable profits.

For example, most fabricating job shops have a list of best customers. These are customers for whom last-minute requests are granted because they've proven it's worth keeping them satisfied. However, the job shops have not learned that the best way to accommodate these requests is by figuring out in advance what the negative impact will be. In other words, don't put revenue ahead of profit by simply assuming it will take care of profitability. Profitability must be figured into the equation.

Making Performance Standards Count

It's hard to imagine what fabricating companies are giving up by not taking the time to quantify their unique performance standards. Even if the task seems difficult to get off the ground, it must begin somewhere.

First, identify the performance standards employees will be measured against. For instance, one of the performance standards for an employee working on a stamping machine might be that employee's productivity rate. Before measuring that employee's productivity rate, however, management needs to determine an acceptable scrap rate and a total output formula.

Once those are set, a lot can be decided based on being able to measure against that standard. For instance, decisions about compensation can be tied to performance standards. Those rising above the standards can be paid bonuses.

Another way companies benefit from performance standards is in determining which decisions actually affect their customers. For instance, employees have enormous responsibility when it comes to cost cutting for a company. Putting employees in touch with the company's realistic performance standards well in advance seems to be the key to cooperation.

Measuring by performance standards is mandatory, because it's one tool companies can use to become more competitive. How else might a company know the point at which enough revenue has been generated to cover overhead in a given month?

By setting and measuring performance and financial standards, a company knows exactly the date this occurs, enough so that it can begin to price competitively if necessary. When faced with a competitive situation, the company that knows the profit that comes from each job can reduce its pricing temporarily to win profitable business it may otherwise lose.

Building a Tracking System

Data collection is valuable only if the shop also builds and maintains a tracking system. Such systems are used throughout the year for daily, weekly, and monthly goals, as well as for identifying the company's key matrices.

In purchasing, for example, a solid tracking system always should be able to identify the acceptable amount of raw material to purchase in a given time period. In turn, the ability to plan could positively affect numbers in the areas of inventory, scrap, waste, capacity utilization, overtime, and so on.

Before making assumptions about where to make changes, management should learn how each of the company's operating units tracks its goals. Once goal tracking is understood, management can modify the systems if necessary and then manage these goals daily, offering the best possible incentives to reach them. With this degree of follow-through, management can be proactive about what's going on in the organization.

View it through the eyes of an athletic coach. Fortunately, coaches don't have to wait until the next game to eliminate newly discovered errors or to test a new strategic play; instead, they have the advantage of play-by-play action. Corporate leaders should see it the same way. Using hourly and daily flash reports helps them manage a given day's opportunities to make changes on the fly.

Performance Standards: Ticket to Success

Performance standards are not only a company's ticket to staying competitive, but to reaching success—if used the right way. Each operation has a performance standard that can be tracked, trended, and measured.

Once management realizes how to do this and identifies these standards accordingly, it will be able to affect pricing, bidding, and quality of work being delivered. And owners and top executives will begin to see the tangible benefits and rewards, as well as a renewed opportunity for finding a quality of life balanced both inside and outside of the business.

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