



# focus

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## Get lean to increase competitiveness and profitability

**A**fter World War II, Toyota was a struggling manufacturer trying to compete with GM, Ford and the world's other automotive powerhouses. Because it couldn't go toe to toe with its larger rivals and their heavily automated assembly lines, Toyota developed a more flexible and efficient system: It removed waste from every step in its processes. This methodology came to be known as the Toyota Production System, which was later dubbed "lean" by Western experts.

Over the past decades, it's been adopted by retailers, many types of manufacturers, health care providers, distributors and other types of businesses. Going lean might be the way to a more productive, profitable future for your business, too.

### Waste not, want not

Lean is about the relentless pursuit, identification and elimination of waste in business processes to produce value for the customer. Lean classifies waste into eight categories:

**1. Overproduction.** Lean operations often avoid or eliminate large-scale production equipment



because the equipment is so expensive and fast that there's a tendency to keep it busy regardless of demand or to produce items in large batches.

**2. Waiting.** Many business processes have significantly more waiting time than actual value-added steps — those that actually provide benefit to the customer. In order processing, for example: Why does it take days for a vendor to ship an item when the time spent entering the order, verifying payment information, pulling the item from the warehouse and packaging it probably takes less than one hour of actual labor?

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**3. Unnecessary transport.** Goods are moved multiple times or there's too great a distance between value-added steps.

**4. Unnecessary movement by workers.** In many environments, employees spend a lot of time needlessly moving around, gathering the materials they need to do their jobs. Lean improvements place items at the point of use as much as possible.

**5. Overprocessing.** Documents may be reviewed or signed by multiple people who really add no value to a process.

**6. Excess inventory.** It takes up space and ties up capital. But worse, excess inventory gets in the way of efficient workflow and poses a high risk of obsolescence.

**7. Defects.** These negatively impact productivity, increase material demand and add other costs, such as for additional inspections. And if defects slip through, they often negatively impact customer satisfaction.

**8. Unused employee creativity.** Some lean implementations fall short of expectations

because they don't focus on continuous improvement. To achieve that requires engaging employees, listening to their concerns and suggestions, and then acting upon them.

### Get to the core of the matter

To eliminate these wastes and achieve the most value for customers, lean projects focus on making improvements by implementing a set of core principles, including:

**One-piece flow.** This principle responds specifically to customer demand, or "pull," as opposed to batch processes. Batch processes tend to create overproduction, excess inventory, excess movement, and excessive delays because orders often must be accumulated over time until there's enough to produce a batch. And, while it seems counter-intuitive, batch processes often result in longer average cycle times.

**First in, first out.** Employing this principle helps companies provide consistent quality and response times and limits the opportunity for out-of-date goods.

**Materials at point of use.** Supplies located as close to operators as possible reduce unnecessary movement.

**Mistake-proofing.** Employing such processes can minimize the opportunity for errors.

**Visual management control.** Processes should be designed so that, at a glance, the abnormal can be easily distinguished from the normal.

**Unified layout.** In lean operations, the processes move from one value-added step to the next with as little non-value-added transport, waiting, employee movement and so forth in between.

**Balanced distribution.** This lean process distributes tasks equally among employees, so that workloads are smoothed out as much as possible.

**Metrics.** Successful lean projects define and track metrics, such as defect rates, cycle times, costs and customer satisfaction, to measure success and know where adjustments need to be made.

### Lean tools

Here are some commonly used lean tools and techniques:

**Value stream mapping.** This is process documentation that graphically depicts a product or service, information, value and waste throughout a process from supplier to customer. It's often used to identify and evaluate improvement opportunities.

**5S.** The five S's are an environmental standardization that's often a precursor to a more extensive lean improvement effort. They stand for:

- Sort – the necessary from the unnecessary,
- Shine – decluttering to reveal potential problems,
- Set in order – organizing the work environment,
- Standardize – clearly documenting and communicating the new environment, and
- Sustain – maintaining the work that has been done.

**Kaizen event.** This is a focused improvement project done over a short period of time with an intense burst of activity.

**Full lean improvement project.** A larger, longer effort that analyzes processes to dramatically reduce waste.



Finally, an important lean concept is standard work. This involves developing standards on how to carry out every step in a process. Employee input on improvements to the standards is encouraged, but changes aren't implemented until consensus is reached. Then, to ensure quality and reliability, all employees are expected to follow the standards.

### Leaning toward a better tomorrow

Lean manufacturing certainly worked for Toyota, which has been perfecting it for 60 years. It's important, though, to lean on the experience of qualified consultants to lead your staff through the first few improvement projects. Then, as more employees develop lean expertise, they can spread lean concepts on their own. |

# Mastering the art of strategic planning

**A**s most businesses grow, strategic planning evolves from a few ideas in the mind of the owner to a more formal process. Sometimes a consultant is brought in, and eventually a formal strategic planning document is developed that lays out key initiatives for the business over the next three to five years.

Unfortunately, what starts out as a well-articulated set of strategic directions often ends up collecting dust — not meeting its potential to help drive the business' success. So how can you make sure your strategic plan grows with the company?

## It's a process, not a document

The strategic planning process should involve collecting relevant facts, setting priorities, weighing competing alternatives and then making choices. While outside consultants can certainly provide valuable assistance in the process, top management must take the lead. Instead of just reviewing and approving a nice binder of initiatives prepared by the consultant, they need to be highly engaged in a process of debate followed by decision making.

Your strategic plan won't go anywhere unless it contains a set of metrics to measure the plan's implementation progress.

When the focus is on the process, not just the output, it's easier to make it an ongoing effort. That's because managers develop a deeper understanding of and buy into the analysis and options that were considered in developing the strategic plan. As active participants in its development, they also have a greater sense of ownership, and thus much more willingness to keep it up to date.



## Define and track

Don't view strategic planning as simply setting long-range goals. A good plan also includes strategies (broad directions to achieve your goals) and programs (shorter term actions required to implement the strategies).

For example, to achieve a goal of doubling market share, you may devise a strategy to open or acquire three new locations over the next three years. Programs will consist of the actions to be undertaken each year to build or buy the new stores.

But your strategic plan won't go anywhere unless it contains a set of metrics, such as incremental market share improvement, and milestones, such as opening the third store on the assigned date, to measure the plan's implementation progress. Accountability is also key. Assign responsible individuals to oversee each goal, strategy or program. And regularly assess their progress against the metrics and milestones.

## Update when needed, not when scheduled

Some businesses make annual updates to their strategic plans, whether they're needed or not. That's certainly better than letting the plan sit on the shelf, but it's not sufficient.

When investigating why so many businesses didn't use their strategic planning process to

drive major business decisions, researchers from Marakon Associates and the Economist Intelligence Unit found that the need to make these decisions didn't always coincide with the annual planning calendar. Rather, an opportunity to buy out a competitor, the loss of key employees, a technological breakthrough, or major disruptions to suppliers or customers created a need to update the plan.

## Discipline, not chaos

Effective strategic planning is difficult. It requires a discipline that many organizations fail to achieve, leaving them directionless and reactive rather than focused and able to create their own opportunities. Businesses that can master the art of strategic planning as an ongoing process stand a good chance of meeting — or exceeding — their long-range goals. ■

## Your IRAs

Taking out is just as important as putting in

**M**ost people include IRAs as a key component of their retirement planning strategies, whether they contribute to the account annually or fund it with a 401(k) rollover. But while you may view your IRA as a savings tool that you automatically add to year after year, you may not realize that the IRS has strict rules on when you can — and when you must — pull money out of the account.

### Traditional vs. Roth

Although traditional and Roth IRAs both offer tax-saving benefits for retirement, each treats distributions quite differently. With a traditional IRA, distributions are subject to your ordinary income tax rate at the time you receive them.

Conversely, with a Roth IRA, qualified distributions are tax free. This has a couple of additional benefits. First, because Roth IRA distributions aren't included in your taxable income, they can't cause any Social Security benefits you're receiving to become taxable, which sometimes occurs when withdrawals are made from traditional IRAs. Also, if your loved ones inherit your Roth IRA, they will owe no income tax on the distributions they take, whereas they will owe income tax on distributions from your traditional IRA.

### Withdrawing too early

Until you reach age 59½, traditional or Roth IRA distributions are generally subject to a 10% early withdrawal penalty.

But, there are instances when you may take early distributions penalty-free. For example, you won't be penalized if you take regular distributions in virtually equal amounts over your life, or if you buy or rebuild a first home — up to a \$10,000 lifetime limit.

You also won't face early withdrawal penalties if you use the funds to pay qualified higher education expenses or medical insurance premiums while you're unemployed. Moreover, those who receive reimbursement of excess medical costs or become disabled may withdraw funds without penalty.

The IRS treats Roth distributions first as nontaxable returns of contributions, so you won't owe tax or the 10% early withdrawal penalty on distributions that don't exceed contributions, regardless of when you take them.

### Recent law enhances IRAs

When the Pension Protection Act of 2006 (PPA) became law on Aug. 17, 2006, it made permanent some provisions from the 2001 tax act affecting IRAs that were to "sunset" after 2010. These include the higher annual contribution limits and "catch-up" contributions for those age 50 and older.

PPA also allows you to direct the IRS to deposit your income tax refunds directly into an IRA, effective for taxable years beginning after Dec. 31, 2006. And, if you're 70½ or older, the law allows you to make tax-free distributions from your IRA (up to \$100,000 annually) to your favorite charity. But act fast: This provision expires at the end of 2007.



### Withdrawing too late

Although Roth IRAs have no mandatory distribution requirement, traditional IRAs do: You must

begin taking annual distributions from these accounts by April 1 of the year after you turn age 70½ and receive subsequent distributions by Dec. 31 each year. If you ignore the deadlines, you'll face a 50% penalty on the amount you should have taken — on top of the income tax bite.

What's worse, the IRS requires delinquent taxpayers to make up such oversights by taking two minimum distributions the next year. This could push you into a higher tax bracket and even cause you to miss out on certain tax deductions, exemptions and credits because your adjusted gross income (AGI) may exceed phaseout levels. And you could incur more tax on your Social Security benefits.

### Never fear, that's why we're here

If all these rules make your head spin, don't worry. We can help you with this very important aspect of your overall retirement planning. ■

## Are you giving on blind faith?

Many charities vie for your donations, but few provide much detail on where your contributions go. Do your dollars go directly to the program? Or are they diverted to administrative and operational needs? The more you know about what charities do with their funds, the better equipped you'll be to make smart giving decisions.

### Following the money trail

Some not-for-profits publish financial statements in their annual reports. While this information may provide a big-picture view, it often lacks sufficient detail to give you a good understanding of an organization's true finances.

To get down to the nitty-gritty, check out the not-for-profit's Form 990. A charity must provide, via the Form 990, detail on its expenses in three major categories: programs, management and fund raising. It also must break down income into 13 categories, such as memberships, program fees, private contributions, government funding, and investment income, and provide backup detail in some cases. The charity is also required to explain key programs and the expenses associated with each. Details on the organization's assets must also be specified and, as with a public company annual report, the nonprofit must list the salaries of the highest paid employees.

### Hitting pay dirt

Except for the list of donors, the entire Form 990 is public information. Charities are required to provide a copy to any interested party at no charge except for a nominal copying fee. You may also request any charity's Form 990 directly from the IRS. But the easiest and least expensive way to view the form is online. Simply go to the Philanthropic Research ([www.Guidestar.org](http://www.Guidestar.org)) or the Foundation Center ([foundationcenter.org](http://foundationcenter.org)) Web site.

If you view your charitable contributions as investments, you'll understand why you must seek organizations that provide good returns by controlling their fund-raising and management expenses and efficiently and effectively providing services.

# Gain a clearer picture of your profitability with ABC

If questioned about profitability, some business owners would answer based on their gut feelings; others would extrapolate information from their financial accounting systems. To more accurately assess your business's profitability, match costs with the activity that drives them. Activity-based costing (ABC) helps you do just that.

## The problem with traditional cost accounting

Traditional cost accounting, also known as managerial accounting, divides costs into direct (such as the labor and materials that go into a product or service) and indirect or overhead costs (such as facilities, equipment, utilities, human resources, marketing and customer service). The indirect costs are allocated according to the direct costs. So, if product A accounts for 65% of all direct labor and material expenses and product B accounts for 35%, indirect costs will be allocated in the same proportion.

The problem with this approach is that many indirect costs don't correlate to direct expenses. For instance, the amount of marketing, customer service, or even amortization of equipment for Product B may greatly exceed that for Product A, even though A's materials and labor are more expensive. This wouldn't be a problem if overhead were only a small portion of total costs, but, in many businesses today, just the opposite is true. So, using the traditional approach may produce bogus information.

## The ABCs of ABC

ABC works very differently, because it takes a multidimensional approach. With ABC, a hierarchy of activities is established, and significant factors that contribute to an activity's cost — called cost drivers — are identified at each level. Some activities will be at the individual product level, such as packaging materials. Others, such as product design, could be at the product line level, while transportation costs can be attached to an order. Yet another set of activities — human resources, information systems, customer service and management — may be at the overall company level.

These cost drivers will vary by activity. In a factory, for example, indirect costs may be driven by the square footage needed, equipment setup and maintenance requirements, and energy consumed. For a wholesaler, shipping costs might be driven by the size of the order, the weight of the order and the mode of transportation.

Using ABC methodology, specific activities — no matter where they occur in the hierarchy — may be linked to a specific product or service and added to the direct labor and material costs of the item.



## Using ABC to your advantage

Implementing ABC doesn't have to be a major undertaking, but it does require a changed mindset. Why? ABC often tests conventional wisdom and creates a situation that challenges the business to make difficult decisions regarding products and customers.

For example, if ABC shows that Products 1 and 2 are profitable, but Product 3 is losing money, management must decide what to do about Product 3 to improve its status. ABC will help the company analyze which activities are adding costs to Product 3 that could be reduced or eliminated and then decide whether it's best to raise the price of Product 3 or even discontinue the product altogether. The same is true for evaluating customer profitability.

## Should you be learning your ABCs?

While ABC grew out of manufacturing, its use is now much more widespread. Retailers, distributors, health care organizations and many other service providers have benefited from using ABC. If your company isn't getting the type of information it needs to properly evaluate its profitability, you may want to consider ABC. ■