Is your year end profit in decline?

As a manufacturer, is your year end profit too low or in further decline?

By Sean O'Sullivan

The four likely reasons why your year end profit is not where it should be or in decline are:

1. Your charge out rate is not remotely accurate.

Because:

- You have not calculated your overhead cost (per staff member per hour) for years;
- You have never actually calculated your overhead cost at all;
- You have opted to charge out at a rate equal to or close to what other local competitors charge;
- Your ratio of non productive to productive staff has increased – and you have not gone back and revised your overhead cost calculation since then;

2. Your average weekly hours of factory downtime is significantly higher than you have estimated;

3. Too many of your products or jobs are being sold for too low a price (either not enough hours allowed or too low a margin);

4.Any combination of the three above.

This article outlines how you can address these four issues today.

Determining your charge out rate

Your annual production hours to be invoiced – per productive staff member

1976 paid hours annually (52 weeks x 38 hours) – Less the following leave (including smoko)

Where your numbers vary amend the template

Leave - Hours per Year

20 days annual holidays (4 weeks)	=160
12 days rostered days off	= 96
10 days public holidays	= 80
10 days sick/personal leave	= 80
1 days bereavement (average)	= 8
Smokos (15 mins per day x 41 weeks x 5 days)	= 51
Total Leave	= 475

475 paid hours annually – where the staff member is on leave or at smoko;

1501 paid hours annually– where the staff member is at work and should be working on manufacturing jobs or downtime jobs.

Estimating your average weekly hours of factory downtime

Total factory downtime includes cleaning, repairs, servicing, meetings, training, stolen time, sStaff standing around talking, waiting for work, changing production priorities and flow – due to client changes and job priority demands, unavailable materials, unsound production planning, time over runs on jobs, variations unpaid, staff induction,rework, warranty work….

The following range of total factory downtime confirms your diminishing chargeable hours – per staff member per year

Calculation - Chargeable Production Hours

10% Total factory Downtime per year 1501 by 90% 1351

15% Total factory Downtime per year 1501 by 85% 1276

20% Total factory Downtime per year 1501 by 80% 1201

25% Total factory Downtime per year 1501 by 75% 1126

30% Total factory Downtime per year 1501 by 70% 1051

35% Total factory Downtime per year 1501 by 65% 976

40% Total factory Downtime per year 1501 by 60% 901

Note: Getting your weekly downtime hours down from 40% to 10% will increase your chargeable hours by 450 hours per staff member per year (1351 – 901). In a business with 10 staff on the factory floor this creates 4,500 additional production hours per year, which, at $75 per hour charge out is $337,500 additional revenue per year.

Thoughts for your consideration:

1. Most manufacturers initially advise that their downtime hours per week is 10% of paid hours. On further discussion most then concede that they do not actually track times on downtimes, or they track them from staff completed time sheets, which they concede are highly inaccurate.

2. Manufacturers who have advanced to time track their downtime jobs and hours per week using PCs on the factory floor see the enormity of their downtime hours per staff member per downtime per day, which in the first month approximates 30% of paid hours.

Pricing too low

Too low a pricing results from: 1. wrong and low charge out rate; 2. overly optimistic budgeted hours (which are far too low) or 3. low margin, which has no allowance for the possibility of the realities of some cost overrun.

My advice is get the following five prerequisites implemented in your business first – then revise your costings, margins and pricing with the help of your financial advisor:

1. Your overhead cost per productive staff member per hour needs calculation – with your current overhead costs;

2. Your costing and sales staff need to break their budgeted labour times per job down to stage of the job – then you need to invest a small amount in PCs on the factory floor and some form of time tracking software to report live and accurate actual times on the same stages of the jobs. This way poor and wrong budgeting or labour times are transparent;

3. Stop manufacturing without recording times on jobs. And stop using time sheets which staff fill in their times on jobs at day or week end (known in the industry as lie sheets, cheat sheets or crime sheets). PCs on your factory floor and time tracking software will replace inaccurate time sheets and will go one step further to motivate factory staff to meet and beat their budgeted and allowed times – thereby increasing production and productivity;

4. Use your PCs on the factory floor and time tracking software to track, report and manage tightly your daily and weekly downtime down to each staff member, each downtime and each day. The enormity of additional potential revenue outlined in #2 above simply from tightly managing your downtimes confirms the financial relevance and importance of this;

5. General Manager to hold weekly meetings with your costing management and production management to review the time tracking software reports – actual time to budgeted time – on all jobs and all stages of jobs. These reports highlight with accuracy and transparency precisely where you are currently losing time and money. Use an A4 journal to record 1. the cause of each negative variation in actual time to budgeted time; 2. the agreed solution to help ensure this issue does not repeat itself tomorrow or the next day. Carrying out this review each week will enable you to highlight then eliminate, one by one, all areas of time slippage in your business.

Follow this advice and you may find it will transform your production, productivity, and annual profit.

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