

MANUFACTURING

POSSIBILITIES



inside

2 Bar Codes and RFID Are Two Top Choices

3 A Lean Manufacturing Environment Benefits From Lean Accounting Practices

Are Your Prices Right?

Reassessing Your Pricing Strategy Can Pay Dividends

OVERVIEW

During an economic downturn, we often rely solely on a “hunker down” mentality and the “survival tactics” that have historically allowed us to ride out the storm. Occasionally, these strategies can unintentionally inhibit future growth, challenge customer relationships or change the overall culture of a company. In the midst of our emphasis on cutting costs, services and perhaps our workforce, many manufacturers neglect to reassess their overall pricing strategy. Doing so can help companies remain profitable and competitive and can also turn short-term challenges into long-term opportunities.

Layoffs, hiring freezes, pay cuts and budget reductions were the go-to survival tactics during the economic downturn. In the midst of this downsizing frenzy, many manufacturers neglected to reassess their pricing strategy. Doing so can help companies remain profitable and competitive in good times and bad.

The first step to optimizing your pricing strategy requires you to identify specific, low-margin products and services. For example, rather than calculating the profit margins of a broader category or division, look at specific products and customer transactions to pinpoint precise areas of low profitability and their causes. Attempt to identify specific products that tend to result in increased overtime during key times of the year. You may find that certain products are far less profitable individually, than is reflected for an entire category or product line. Furthermore, if you have customers that only purchase low-margin products, consider whether larger profits can be realized in the long run by reassessing or restructuring the company’s involvement in this area.

After identifying the “low-hanging fruit,” the next step is recognizing the various customer types or categories your company services. What does this entail? As all customers are not alike, consider categorizing them based on their willingness to pay, volume of purchases, diversity of purchases and

the amount of value they place on your products. Long-time customers who value the quality and service they receive are more likely to allow a manufacturer to maintain reasonable margins on the products they sell, with a minimal amount of resistance.

For example, a customer who buys an optional part for an insignificant piece of machinery will be less tolerant of high prices than a customer who purchases a crucial part for an expensive, indispensable piece of machinery. Other factors to consider might include the number of alternative suppliers available, the complexity involved in meeting customer specifications and the overall customer profile. By using this type of criteria, management should attempt to establish relevant and specific pricing and negotiation guidelines, which can be utilized in assigning customers and products into pricing groups.

While pricing should be flexible, it’s also important to rein in sales negotiation activity that may have a negative impact on margins. Set and enforce policies that prevent salespeople from going too low as a way to win customers and secure commissions.

Last, but not least, remember that flexibility and responsiveness are crucial to a successful pricing strategy: Companies must be able to assess and react quickly to volatile environments, customer needs and competitors’ pricing behavior. ■



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The Technology Behind Inventory Tracking

Bar Codes and RFID Are Two Top Choices

OVERVIEW

In the distribution industry, accurately identifying and tracking inventory is job number one. There are two types of technology to perform these tasks: bar codes and radio frequency identification (RFID). This article looks at how each works and explains their respective pros and cons in regard to such issues as cost, convenience, security and privacy.

In the distribution industry, bar codes and radio frequency identification (RFID) are the two technologies that accurately identify and track your company's inventory. But how does each technology type work and which one is right for you?

Bar Coding vs. RFID

Bar coding and RFID fall under the umbrella of automatic identification (auto ID) technologies. In general, such technologies serve to increase accuracy and overall efficiency in identifying and tracking inventory.

But they differ in how they work. Bar coding is a line-of-sight type technology, meaning it uses scanning devices that see and read bar codes affixed to inventory. To be read, bar codes must be carefully positioned toward the scanning device and be in good condition. Dirty or damaged labels can't be properly scanned. Bar codes also are limited in the amount of information they can include; for example, they can identify the manufacturer and product but not the specific item.

An RFID system, on the other hand, communicates inventory data via a radio frequency channel or wireless technology. A reader device transmits an identification request to an identification tag affixed to inventory. The tag relays the requested information back to the reader device, which then transmits it to a computer.

Data encoded within an identification tag may include the item type, location (such as in the warehouse or in transit), and any special handling instructions. RFID tags don't require a direct line of sight to be read; they can be read as long as they're within range of a reader device.

Pros and Cons

Whether RFID is better than bar coding depends on your distribution business's needs. Bar coding generally is less expensive to implement than RFID, and it provides adequate, cost-effective inventory identification and tracking capabilities for many companies. In some cases, combining the use of RFID and bar coding technologies also may provide a cost-effective solution.

Overall, the advantage to RFID is that it offers faster data processing and broader ranges for reading data on tags, which don't need to be positioned outward to be read and offer more specific data.

Keep in mind that continued standardization efforts are also essential to furthering the use of RFID worldwide. In fact, the frequencies used for RFID in the United States currently are incompatible with those of Europe or Japan. And in the United States, UHF-based RFID, featuring a longer read-range, has relatively new standards that distributors must familiarize themselves with if they wish to use this newer technology.

Security and Privacy Risks

Some technology experts advise caution regarding the potential for security risks with the use of RFID technology. RFID applications may lack crucial user identification and encryption features or could possess coding errors or weaknesses, making them vulnerable to hackers and destructive viruses and worms. Malicious attacks that exploit such vulnerabilities could therefore wreak havoc on your computer systems.

There's also a concern about the possibility of businesses using RFID to track customers' purchases and extract information from the purchases without their knowledge. Some people also worry about the government using the technology for surveillance purposes by tracking individuals' whereabouts. This raises the need for businesses to protect and inform their customers about any data being collected on them and how it may be used.

In effect, as you compare and evaluate RFID applications, also consider the potential security and privacy risks, and how you can minimize concerns for your business and customers.

Making the Right Choice

As a distributor, you're in the business of accounting for inventory. Whether you choose to do that using bar codes or RFID depends largely on whether your company can afford the higher-priced RFID technology. Bar codes will be less expensive, but RFID offers a host of additional benefits. Consider hiring an IT consultant to help you determine the right choice. ■



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One Supports the Other

A Lean Manufacturing Environment Benefits From Lean Accounting Practices

Lean manufacturing is nothing new — many manufacturers adopted this business model during the last decade. But did you know that lean accounting is crucial to operating in a lean manufacturing environment?

Lean accounting focuses on two goals:

- Converting financial statements into “plain English,” and
- Eliminating waste by taking the focus off the minutiae.

Standard Costs vs. Lean Accounting Statements

The transparency of lean accounting is helpful in demonstrating the benefits of lean manufacturing initiatives and optimizing day-to-day business operations. Because standard cost accounting rewards overproduction, using standard methods to try to demonstrate the value of lean processes that eliminate production waste would be futile. Lean accounting, on the other hand, reveals savings and costs that might otherwise be misinterpreted or hidden — the true cost of labor and machinery, for example.

For manufacturers that run on lean management principles, not using lean accounting principles can, in fact, be downright harmful. Case-in-point: Standard profit and loss statements can put a negative spin on the inventory reduction that comes with the implementation of lean manufacturing processes. That’s because production isn’t completely absorbing overhead and labor costs, so these costs appear on statements as deferred costs. This can be a red flag for owners, executives and investors, preventing the benefits of lean manufacturing from shining through.

For example, if a manufacturer produces less product on a quarterly basis, standard cost accounting statements might indicate that the cost of manufacturing each unit goes up because labor and overhead aren’t being absorbed as quickly. In other words, standard cost accounting says that the higher a company’s production rate, the less each unit costs in terms of labor and infrastructure, as these costs will be divided up among more units. This not only can cause

concern among owners, executives and investors, but also can lead manufacturers to price their products inaccurately, making them less competitive. Lean accounting methods, on the other hand, might reveal a lower actual cost per unit, because, in reality, the machines used to make the product are owned by the company and labor costs are minimal.

Lean accounting can avoid this problem by converting financial statements to plain English and using metrics that are clear and objective and support lean initiatives. Deferred labor and overhead costs, for example, have no place on a lean accounting statement.

Also, while traditional statements may account for a fixed-dollar amount of overhead for every dollar of inventory spent, lean accounting looks at these costs as variable, assessing the true costs of labor and overhead on a case-by-case basis. Statements should also align with value-stream maps — visual representations of the end-to-end production process — which can give owners and executives a clear picture of their companies’ financial situations.

OVERVIEW

Lean accounting is crucial to operating in a lean manufacturing environment. This article describes some of the advantages of lean accounting vs. standard cost accounting, along with some of the disadvantages. A sidebar discusses the status of lean accounting in university curricula.

Lean Accounting—continued on page 4



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Lean Accounting—from page 3

The Lean Lag

While lean accounting provides accurate, easy-to-understand views of finances in lean manufacturing environments, hurdles to acceptance of lean accounting methods remain. Traditional accounting practices are still a compliance necessity because lean accounting won't, for example, satisfy IRS requirements. Likewise, public companies are required to issue financial statements following Generally Accepted Accounting Principles (GAAP), and private companies may have to provide GAAP-compliant statements to lenders. So financials may need to be done twice. Additionally, lean accounting requires a significant change in the way people think about accounting. Company accountants that know standard cost accounting and GAAP inside and out likely won't be very familiar with lean accounting methods.

Finally, lean accounting requires buy-in from departments outside of finance, including IT, operations, engineering and customer service, because they must all adapt to using lean accounting metrics to measure and analyze performance within their departments.

Is Lean Accounting Right for Your Company?

Even though lean accounting can't replace traditional accounting practices, it can go further in helping owners and executives make accurate, informed business decisions. It's also a necessity for manufacturers who want to see the true financial effects of their lean manufacturing initiatives. Lean accounting may not be right for every organization, but manufacturers that are committed to and invested in lean manufacturing practices should consider supporting them with simplified, lean accounting processes. ■



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