As Hiring Returns, Will Efficiency Be Lost?

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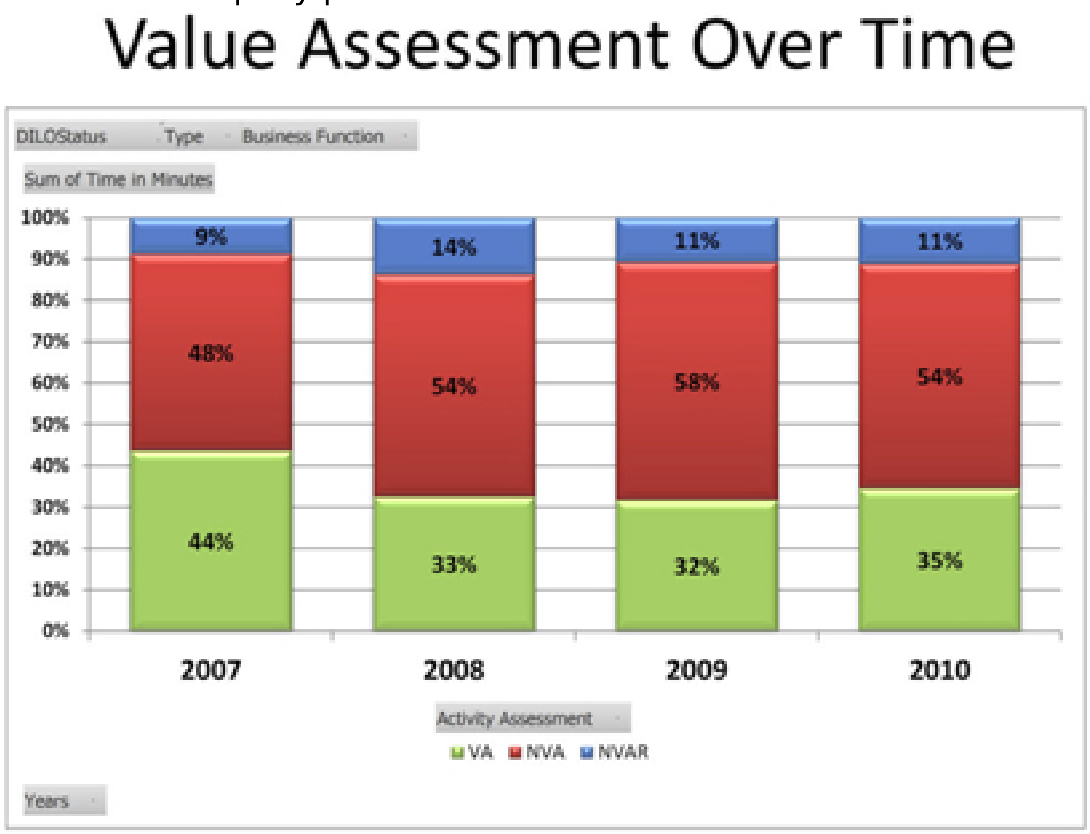
Recent economic news might be the first signs of light at the end of this three year tunnel for the manufacturing industry, as positive momentum is gathering around jobs data. Certainly a welcome indicator as the sector still struggles under the weight of a recession that saw manufacturing profits after tax collapse to the tune of 40 percent from 2007 to 2008, according to the US Census Bureau.

However, the Bureau of Labor Statistics (BLS) announced that in April, overall employment was on the rise and “thirteen of the 21 manufacturing subsectors experienced over-the-year decreases in initial [unemployment] claims, with the largest declines occurring in transportation equipment and machinery.”

As the turnaround takes hold, companies stand at a crossroads. Recognizing the difference between headcount, budget control, and value of the workforce will be a major factor in taking the best path to revival. The most common first reaction to the plunge in 2008 was a round of cost cutting layoffs – and all too often those measures were mistaken for value creation. Mass reductions in labor can improve the bottom line in the short term, but they can also introduce long-term, damaging effects on company performance.



Value lost, lessons gained

A field study conducted by Celerant Consulting examined the value created within organizations over this timeframe, and determined which areas of the enterprise are most prone to lagging in productivity and which can be impacted to improve output (for more, see the 2011 Impactability Report [1]). Perhaps most important, the study drew firm correlations between ideal employment levels and company output. There is a fine line between building a workforce focused on value and one that fights against it, and leaders who strike the right balance can be more effective at turning value into profitability.

Covering the period from 2007 to 2010, the Report looks at internal and government data collected during one of the most tumultuous times in American economic history. The data consists of over 21,000 individual log entries totaling more than 2,500 hours of direct observation of employees across 22 firms in the United States and Canada.

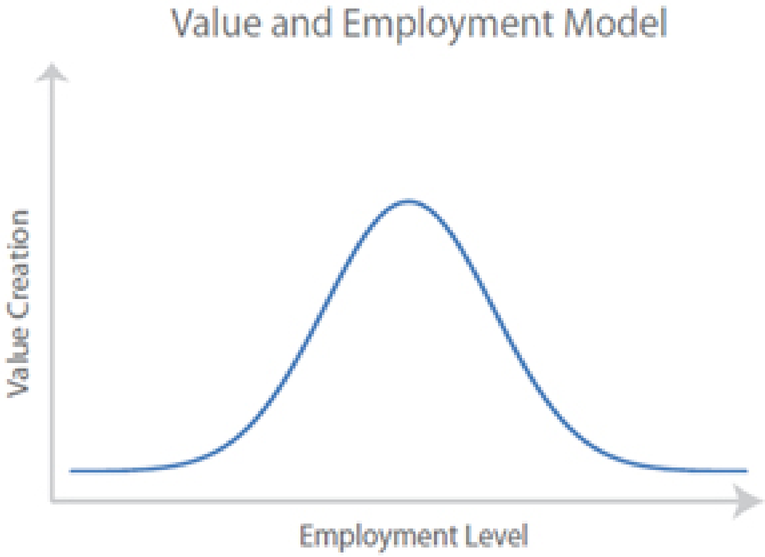
In a minute by minute breakdown, time was divided into three categories: valueadded (VA), non-value added (NVA), and time spent on activities such as regulatory reporting that do not add value but are required (NVAR). All activity was further assessed for impactability– that is, time that can be easily converted into VA time through the use of process improvement with minimal or no use of capital.

The most striking finding speaks to the loss of value that spans the downturn, as workforces engaged in value adding activities during 44 percent of their day in 2007, then dropped to about 33 percent in 2008 and 2009.

It is no surprise that day-to-day productivity would suffer in such a difficult environment, however as jobs come back there is opportunity to control growth with value in mind by following a “Value to Profit” model. The model is captured by a cross-reference of data from the Impactibility Report and the BLS, which demonstrates an extremely strong correlation between rising value-added time and increased output in manufacturing across all sectors. Simply put, employers who can drive up the amount of value created by employeeswill see their output rise almost in equal measure.

That finding may seemself-evident, however less instinctive is another balance that must be struck: overemployment can be as destructive to value as running on a skeleton crew. If the staffing level is too low, the workforce will be unable to produce at the most profitable level; too high, on the other hand, and an operation will be weighed down by additional costs and unneeded levels of complexity.

As revenues regain stability, employers must take a lesson from the downturn by increasing labor in a slow, steady manner that is supported by training and organizational roadmaps designed to maximize the value of each employee. Non-value adding (NVA) time that naturally accompanies a larger workforce can then be held at bay, and companies can better track their output directly to the ideal balance of people, processes, and value.



Striking the balance

Of course, it is no easy task to apply the discipline necessary to rebuild under a more restrained, structured system. Leaders must start by establishing their vision and Key Performance Indicators (KPI) that will tell individuals and teams if they are headed in the right direction.

One broad measure that can be put in place is Overall Equipment Efficiency (OEE). This is a well-tested performance indicator that is a telling metric for asset effectiveness and takes into account availability of equipment, rate of production, and qualityof workmanship.

OEE done right ensures efficiency of utilization for physical assets and materials. It does, however, leave one very important component out of the equation: financial performance.It is admirable to boast the highest OEE in the industry, but not if actual cost of production skyrockets because too many resources are devoted to one goal. Improving the value adding time of employees by focusing their time on tasks related to OEE improvement will help keep equipment running for longer periods of time, ensuremore reliable productivity, and impacts costs through less waste contributing to the overall objective.

A better measure for financial operating performance isReturn on Assets (ROA). This measurement expresses the relationship between the assets of a firm and its ability to sell product profitably, revealing the effectiveness of interaction between production and sales. Issues with these functions traditionally manifest at the general manager level, however a related finding from the Impactibility study tells us that time is often lost in rework (performing tasks multiple times due to error), extended breaks, unnecessary meetings, searching for resources, and on-site travel time that could be avoided. Reducing these activities at the lowest levels improves value creation which improves profitability, and in turn improves ROA.

These two metrics can work together in harmony. Where OEE provides visibility to the current state of day-to-day production, ROA provides a high level goal setting measurement for developing strategy and providing guidance for long term planning. These are just two of many possible performance indicators, and leaders should bear in mind that the most important element of creating such measures is to ensure that individuals know how they can directly influence the metric. A team that feels informed and connected will be more inspired to deliver results. Not only will this help increase production per employee, it will also help to win the hearts and minds of the employees charged with spearheading a transformation or rebuilding effort.

Employees who are given the structure and tools to increase the amount of value they create, even by just a few percentage points, can save struggling companies and rally those that are well positioned to take advantage of the recovery to even loftier heights of profitability. When forward thinking businesses adapt by focusing more of their workforce on value, they will be less likely to be pulled down by pitches in the economic climate and more likely to stay stable, profitable, and ahead of the curve.

Links:
[1] http://www.celerantconsulting.com/Downloads/Perspectives/Celerant%20Impactability%20Report_2011.pdf