



Proving Continuous Improvement with Profit Ability

FACT: Every employee in every function at every level and every hour makes financial decisions that affect Net Profit & Asset Investment whether or not they or management realize it.

Course Outline:

- a) Learn the 7 critical elements in which financially sound improvements are found.
- b) We will create and utilize Value Analysis type verb/noun phrases to discover and name projects.
- c) Learn a project evaluation process and forms to financially rank projects and to define which ones will increase the profitability of your organization.

Understand the seven key financial elements and “HOW” to interact within them:

Increase Market Share percent to increase Sales Dollars

Reduce labor & non-labor percent expenses per Sales Dollars

Reduce lead times to minimize work-in-process inventory investments

Reduce manufacturing & purchasing setup cost to reduce lot sizes for component and product inventory

Maximize capital asset utilization to minimize capital asset investment

Control customer invoice collection period to minimize Accounts Receivable investment

Maximize employee asset utilization by setting up project teams

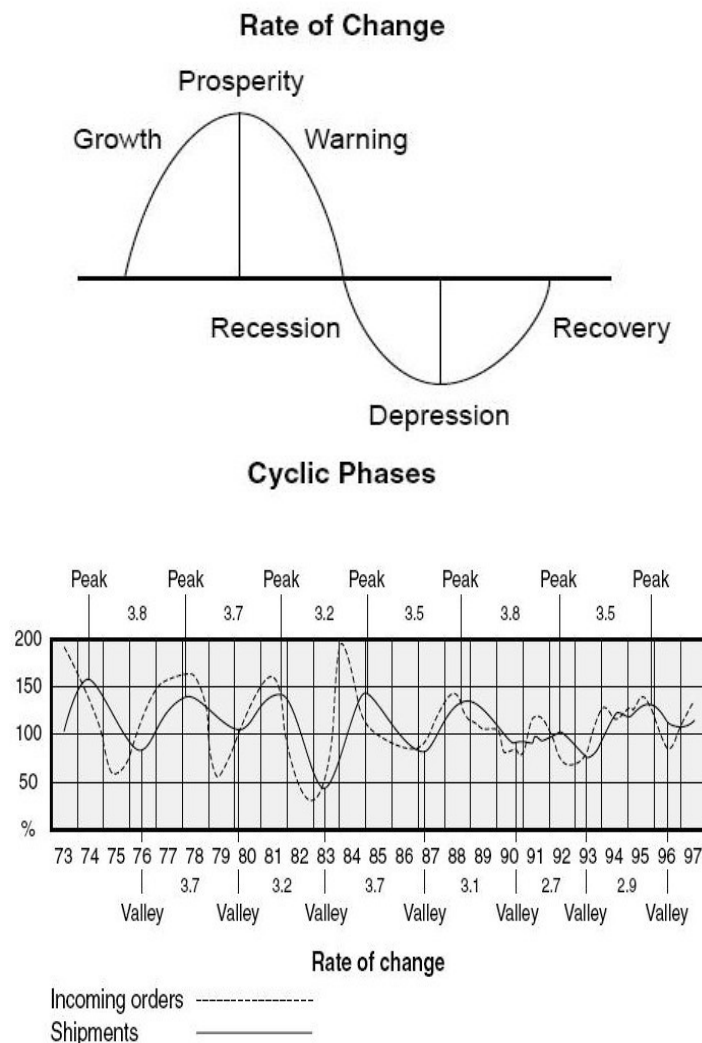
Gilbreath's Profit Ability Continuous Improvement Process can be a stand alone companywide improvement process, or it can be used to enhance existing Lean/Six Sigma programs.

It is based on the fact that *every* employee at every level in *every* function of a business makes financial decisions *every* hour that impacts the profitability and the Profit Ability of the enterprise? Therefore, Gilbreath's has designed a training program and consulting service to:

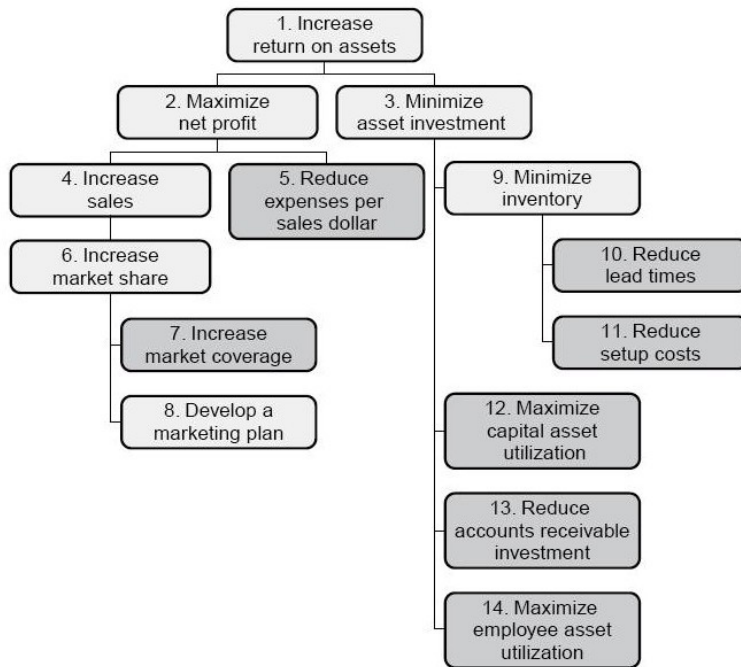
- show employees how to organization the knowledge, that some one in the company already possesses, so the profitability of the business can be doubled,
- as measured by the average Return on Assets percent,
- over *their* next three to five year business cycle,
- using the formula, $Average\ ROA\ percent = Net\ profit\ dollars \div Asset\ investment$

There are several unique features of the Profit Ability process that sets it apart from Lean/Six Sigma programs and yet, either enhances existing Lean/Six Sigma programs, or applies Lean/Six Sigma concepts by focusing them on the improvement projects which will increase the average Return on Assets percent the most.

We show company leaders and continuous improvement teams how to calculate and plot their own business cycle so they can focus on the right improvement projects during all six phases of a business cycle, particularly in the current 2011/2012 recovery phase.



A second unique Profit Ability feature is that we prove that there are only seven key business elements from which profitable continuous improvement projects can be found.



These seven elements, expressed as verb/phrase combinations are:

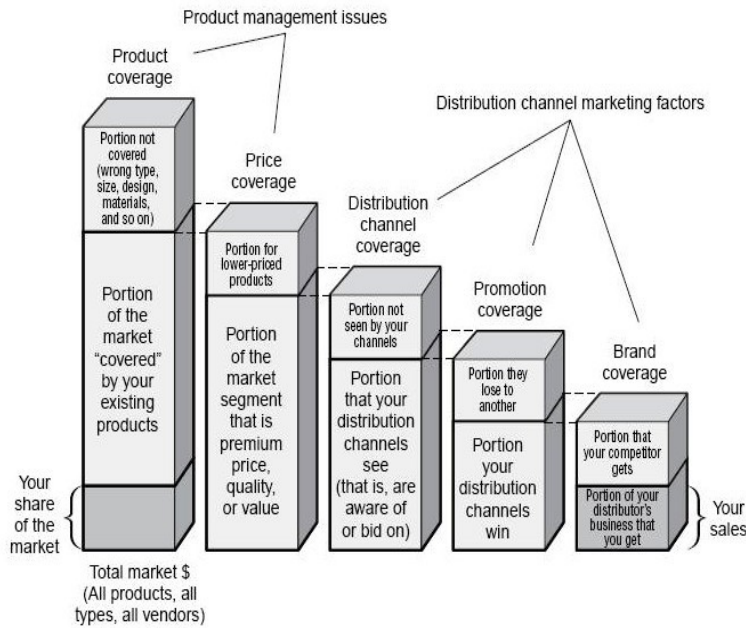
- Increase sales dollars and market share percent, *permanently*, by increasing market coverage.
- Reduce labor and non labor costs *per sales dollar*, to increase Net Profit dollars and Net Profit percent.
- Minimize the asset investment for component and product inventory dollars by reducing setup costs and by reducing the mismatch between processing lead time and customer order lead time.
- Minimize the work-in-process inventory dollars asset by reducing paperwork and component processing lead time, to minimize the work-in-process asset investment.
- Maximize the capital asset utilization percent to minimize the capital asset investment.
- Minimize unpaid invoice dollars by minimizing the Accounts Receivable asset investment to equal the collection period agreed to by the purchase order/contract.
- Maximize knowledge asset utilization by training employees, *companywide*, with the right financial knowledge and to make them better businessmen and businesswomen.

A third unique Profit Ability feature is that it proves that the only way to permanently increase sales, by permanently increasing market, is to increase market coverage for product range, price range, marketing channels, promotion, and brand label.

As illustrated by the following graphics, market share is totally dependent on the total level of market coverage, and there is a limit to how much coverage will significantly increase market share. Therefore, a business needs to have a financial tool to determine when to stop investing in more improvement.

Analytical Assessment of Market Share

- When selling through indirect channels (who carry competing brands), there are five coverage measurements
- When selling through indirect channels (who are exclusive), there are four coverage aspects (that is, brand coverage becomes 100 percent)



Product	Price	Channel	Prospect/ Promotion	Customer or Brand	Market Share
50%	X	50%	X	X	50% X 50% = 6%
50%	X	50%	X	50%	50% X 50% = 3%
60%	X	60%	X	X	60% X 60% = 13%
60%	X	60%	X	60%	60% X 60% = 8%
70%	X	70%	X	X	70% X 70% = 24%
70%	X	70%	X	70%	70% X 70% = 17%
80%	X	80%	X	X	80% X 80% = 41%
80%	X	80%	X	80%	80% X 80% = 33%
100%	X	100%	X	X	50% X 50% = 25%
100%	X	100%	X	50%	50% X 50% = 13%
100%	X	100%	X	X	80% X 80% = 64%
100%	X	100%	X	80%	80% X 80% = 51%

Figure 5.1 Market Share Estimator.

A fourth unique Profit Ability feature is a means to financially calculate if projects discovered from the seven key business elements will actually increase the average ROA percent and which will increase the average ROA percent the most. The form below is a

combined profit and loss statement and balance sheet which estimates how much a 10% sales increase should increase the ROA percent.

ROA Goals for Increase Sales 10%

Line	Data Description	Base data x 1,000	Plus 10% Sales	New Values
1	Total Sales	10,000	1,000	11,000
2	Purchased. Materials and Parts	3,000	300	3,300
3	Setup-Direct Labor	100	10	110
4	Run-Direct Labor	600	60	660
5	Indirect Labor	600	12	612
6	Manufacturing Salaries	600		600
7	Mfg. Non-Wage Overhead	2100	42	2,142
8	Less Total Mfg. Expenses	7,000	424	7,424
9	SE & A Salaries	1,300	150	1,450
10	SE & A Overhead	700		700
11	Less SE & A Expenses	2,000	150	2,150
12	Less Project Team Expenses			
13	Net Profit Before Tax	1,000	426	1,426
	Asset: Investment:			
14	In-process Inventory	700	70	770
15	All Other Inventory	2,300	230	2,530
16	Capital Assets:	5,600	112	5,712
17	Accounts Receivable	1,400	140	1,540
18	Total Asset Investment:	10,000	552	10,552
19	ROA Percent of Sales	10.000%		13.514%

A fifth unique Profit Ability feature is the use of a Value Analysis tool to ask the question, “How do I make this particular improvement?” For example, “How do I increase the ROA?” The previous chart showing the seven key business elements answers, “Maximize Net Profit and Minimize Asset Investment.” Then, we might ask, “How do I increase sales and market share?” and the chart will answer, “Increase Market Coverage.” Then, when we ask, “How do I increase market coverage we will end up with a list verb/phrase combinations for which we keep asking, “How?” until we get the name for specific projects which we will financially evaluate, using a form similar to the one above.

- Acquire an accepted low-cost product line.
- Create a new line that is private-labeled.”
- Change distribution channels
- Add more distributors
- Pull more products and services through existing distributors.”
- Improve improved on-time delivery and cost control and advertise it.
- Change advertising to emphasize customer financial benefits
- Increase advertising
- Target specific industries
- Improve distributor training
- Provide the sales force with better targeted selling tools.”

A sixth unique Profit Ability feature is a chart, related to the goal to reduce setup costs, which shows how to rationalize the mismatch between purchasing and processing lead time and customer order lead time. This chart is an exploded assembled-product bill of materiel on which purchasing and processing lead times are compared to the allowed customer order lead time, so the specific components which are causing customer orders to be delivered late can

be identified and to identify which specific components require an additional inventory investment because of lead time and setup cost issues.

ROA Goal to Reduce Setup Cost 50%

Line	Data Description	Base data x 1,000	Minus 50% Setup Cost	New Values
1	Total Sales	10,000		10,000
2	Purchased. Materials and Parts	3,000		3,000
3	Setup-Direct Labor	100	-50	50
4	Run-Direct Labor	600		600
5	Indirect Labor	600		600
6	Manufacturing Salaries	600		600
7	Mfg. Non-Wage Overhead	2100	-172.5	1,927.5
8	Less Total Mfg. Expenses	7,000	-222.5	6,778
9	SE & A Salaries	1,300		1,300
10	SE & A Overhead	700		700
11	Less SE & A Expenses	2,000		2,000
12	Less Project Team Expenses			
13	Net Profit Before Tax	1,000	222.5	1,222.5
	Asset: Investment:			
14	In-process Inventory	700		700
15	All Other Inventory	2,300	-1,150	1,150
16	Capital Assets:	5,600	560	6,160
17	Accounts Receivable	1,400		1,400
18	Total Asset Investment:	10,000	-590	9,410
19	ROA Percent of Sales	10.000%		12.991%

Lead Time Mismatch Chart

Cycle time chart		Each column equals one week						
Part no.	Item name				Spec. eng. dwg.	Info lead time	Cust. order rec.	
1	End-item assembly							
2	Subassembly							
3	Purchased part							
4	Manufactured component							
5	Bar stock material							
6	Manufactured component							
7	Casting material							
8	Special subassembly							
9	Special manufactured part							
10	Tubing material							
11	Purchased part							
12	Customer part							
13	Manufactured component							
14	Bar stock material							
15	Purchased part							
16	Purchased part							
17	Manufactured component							
18	Casting material							
19	Grinding operation							
20	Heat treat operation							
21	Machining operation							
22	Bar stock material							
23	All hardware							

The seventh unique Profit Ability feature is the claim, *and proof*, that the average ROA percent of a business can be doubled over a three to five year business cycle. Any business can use the following form, and by inserting their own numbers and a reasonable improvement goal for each of the seven key business elements, can prove to themselves that the Profit Ability process will show them *HOW* to double their own average ROA percent.

ROA Goal Total for all Seven Project Groups

Line	Data Description	Base data x 1,000	Total Changes	New Values
1	Total Sales	10,000	1,000	11,000
2	Purchased. Materials and Parts	3,000	300	3,300
3	Setup-Direct Labor	100	-50	50
4	Run-Direct Labor	600		600
5	Indirect Labor	600	-48	552
6	Manufacturing Salaries	600	-60	540
7	Mfg. Non-Wage Overhead	2100	-340.5	1,759.5
8	Less Total Mfg. Expenses	7,000	-198.5	6,801.5
9	SE & A Salaries	1,300	20	1,320
10	SE & A Overhead	700	-70	630
11	Less SE & A Expenses	2,000	-50	1,950
12	Less Project Team Expenses			
13	Net Profit Before Tax	1,000	1,248	2,248.5
	Asset: Investment:			
14	In-process Inventory	700	-280	420
15	All Other Inventory	2,300	-1,274	1,026
16	Capital Assets:	5,600	112	5,712

17	Accounts Receivable	1,400	-60	1,340
18	Total Asset Investment:	10,000	-1,502	8,498
19	ROA Percent of Sales	10.000%		26.459%
20	Improvement Team Expense			320
21	Adjusted Net Profit			1,928.5
22	Adjusted ROA Percent			22.694%

The individual goals on which the above chart was based for our imaginary business are:

- 10% permanent average sales dollar increase because of increased market coverage
- 10% reduction for salary and wage expenses per sales dollar
- 10% reduction of overhead expenses per sales dollar
- 50% lead time reduction (work-in-process investment) within the next three to five years
- 50% reduction in setup costs for the 20% of components that make up 80% of total setup costs
- 5% reduction in capital asset investment at the peak of the business cycle
- Control of the invoice collection period to equal the agreed purchase order time limit

If you want to know HOW your companywide employee knowledge resources can help you double the ROA of your business, between 2011 and 2015, contact Dale Morgan at Gilbreath's LLC:

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