CASE STUDY: IMPROVING CASH FLOW FOR LONG-TERM PROFITABILITY

Overview

The company is a privately owned manufacturer of automotive drive-train testing and repair equipment. After decades of success, the company emerged from the recession with its sales cut in half, excessive overhead costs, rising lead times and a growing list of vendors unwilling to provide parts. In an increasingly competitive industry segment, management executives knew they needed to improve the company’s cash flow and profitability quickly in order for it to remain viable for the long term.

Identifying the issues

The automotive repair and aftermarket performance industry is not growing as it once did and, as a consequence, the need for new automotive maintenance equipment is decreasing. Over time, some decisions made before the recession came to have an adverse effect on company performance and finances.

In order to secure a low price–per-unit on supplies, for example, the company often ordered in bulk. This approach led, however, to the accumulation of a significant amount of excess inventory that would sit in one of two warehouses nearly 600 miles apart: 25 percent of their inventory had not been used for 12 months, and some of the inventory was either obsolete or not what was needed. MRP systems were in place, but were not being fully utilized. The storage facilities themselves were nearly twice the square footage that the company needed. Given the stagnating sales growth, much of this inventory was not likely to turn over very quickly, if at all.

Resources were spread thinly across many product lines and, as a result, quality standards had become an issue of concern. Flexibility for modifying bills of materials and assessing potential outsourcing of manufacturing also were issues. Many parts drawings were not up to date. Unstable working capital management led to changes in vendor relationships and, consequently, lower quality parts. Longer lead times resulted in lost sales and customer dissatisfaction. Poor cash flow was keeping research and development to a minimum.
Product enhancements were limited, and this served to diminish the company’s distinctive brand, which had been built in part on the company’s focus on innovation.

Over the years, organizational culture led the company to develop or acquire a number of product lines. But management now found itself unable to provide the engineering, sales and marketing support for many of their products. Custom work was consuming much-needed engineering time for design and for responding to requests for proposals.

As with so many manufacturers, the company found itself at a crossroads with its workforce. It was relying on a small number of senior mechanical and electrical engineers who were critical to the lifeblood of the company. In order to provide ongoing support for the company’s product lines, the upcoming generation of engineers needed the knowledge and expertise of these specialists.

Many of the company’s products were being sold at premium prices, some by as much as 20 percent above market prices. With a commission plan that did not sufficiently encourage growth, the sales staff was not inspired. Yet pipeline data supported the potential of a larger market for the products.

The RSM solution

Improving the company’s cash flow and enhancing its profitability became the top priorities for management and the RSM service team. Together, company executives and RSM specialists developed a realistic road map that addressed the following areas:

- **Inventory**—Discontinued products and slowmoving inventory were assessed and plans developed to liquidate some of the inventory in an effort to make a significant contribution to working capital as well as to pay off debt. Scorecards measuring vendor effectiveness and updated parts drawings were utilized to improve and maintain quality; purchasing best practices helped reduce excess inventory and consumption of working capital.
- **Product lines**—Divesting itself of or discontinuing a number of secondary products enabled the company to focus resources on its core products, increase its working capital and decrease expenditures. Design modifications were made on some products to align them better with the market demand for lower price points.
- **Real estate**—Consolidating space in the company’s two office and warehouse facilities allowed for savings in operating costs. The plant layout for one facility was modified to allow the company to share space with a sublease tenant, yielding modest but welcome revenue.
- **Sales and pricing**—Changes were made in commission threshold incentives and base salaries to more effectively grow sales. Competitive pricing adjustments were made on a number of products to align with market rates where profitability was anticipated.
- **Workforce**—Senior engineers were directed to cross-train others, document procedures and drawings, and complete key engineering and software development initiatives. Engineering was reorganized to improve prioritization, consistency and accountability. Most importantly, cross-training provided the organization the flexibility it needed to be positioned for strategic alternatives, such as facility consolidation, joint ventures, outsourced manufacturing or outright sale.

Preparing for the future

The impact of these initiatives can be felt throughout the company: inventory turnover has increased significantly and on a more predictable basis; excess inventory has been appreciably reduced; pricing adjustments have made the company more competitive; sales volume is forecasted to rise; and a significant amount of working capital is now available.

As infrastructure and technology needs are met and operations stabilize, the firm can turn its attention to long-range plans, which include investigating potential strategic alternatives to its current business structure.

In an increasingly competitive marketplace where price has become an important differentiator, management is exploring joint venture, merger and outsourcing options with various manufacturers. As the company moves forward, management will continue to assess the market and adjust products, procedures and pricing accordingly.