Achieving Breakthroughs in Profits and Cash Flows

Noida Management Association

August 20, 2016

pgt partners

Agenda

- Goal of a Business Organisation
- Why organisations find it difficult to achieve the Goal?
- What to Improve and How to Improve
- Implemented case studies from India
- Summary

Section 1

Goal of a Business Organisation

The Goal?

Why do you need a goal?

pgt partners

The Goal?

What is the Goal of a business organisation?

The Goal?

Some organisations state that their Goal is to delight their customers now as well as in future.

pgt partners

The Goal?

Many other organisations say that their Goal is to keep their employees happy, now and in future.

The Goal?

A few organisations declare that their Goal is to make money, now and in future!

The Goal?

Customers
- Good Products
- Good Services

Employees
- Job Satisfaction
- Sense of Well Being

Owners
- Profits
- Growth

pgt partners

The Goal?

So how do we decide on the goal of a business organisation?

The Goal?

Is there any conflict between the three Goals stated or a hierarchy of Goals?

- Customer Satisfaction
- Employee Satisfaction
- Owner/Shareholder Satisfaction

pgt partners

The Goal?

- For example, let us choose that our Goal is to delight customers now and in future.
- In order to achieve our chosen Goal, that is to delight our customers now and in future, it is absolutely necessary to keep our employees happy now and in future.
- Similarly it is imperative to make money now and in future in order to continue to keep our employees happy.

pgt partners

The Goal?

- Now let us decide that our Goal is to keep our employees happy now and in future.
- In order to achieve our chosen Goal, it is absolutely necessary to make money now and in future.
- It is impossible to make money now and in future unless we continue to delight our customers now and in future.

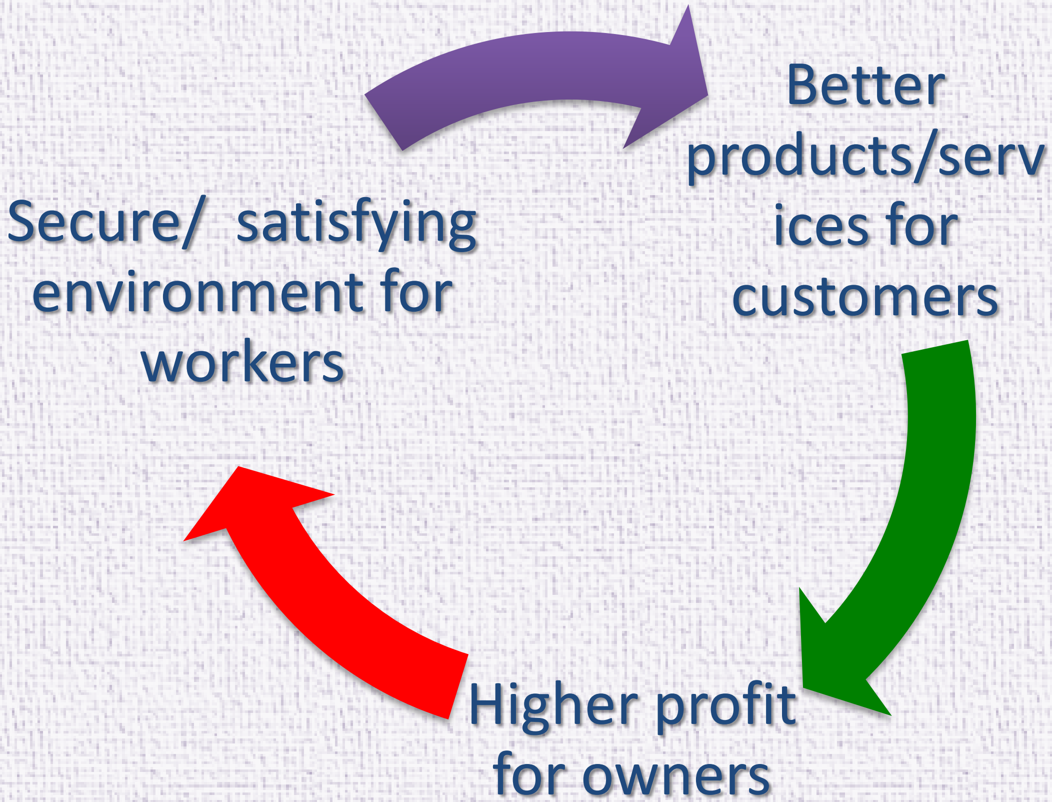
The Goal?

- On the other hand, if we decide that our Goal is to make money now and in future, is it really possible to achieve it without delighting our customers now and in future!

- And can we satisfy our customers without keeping our employees happy now and in future!

The Goal?

Choose any of the three Goals, the other two become the necessary conditions for achieving the chosen Goal!



pgt partners

The Goal?

Choose any of the three Goals, the other two become the necessary conditions for achieving the chosen Goal!

pgt partners

The Choice

- In our work, we **Choose** that the **Goal is** making money now and in future, that is **making more and more money**.
- We choose this simply because this is the only one of the three areas which is **easy to measure**!

Section 2

Why organisations find it difficult to achieve the Goal

Measures for the Goal - Making Money

Generally accepted measures are

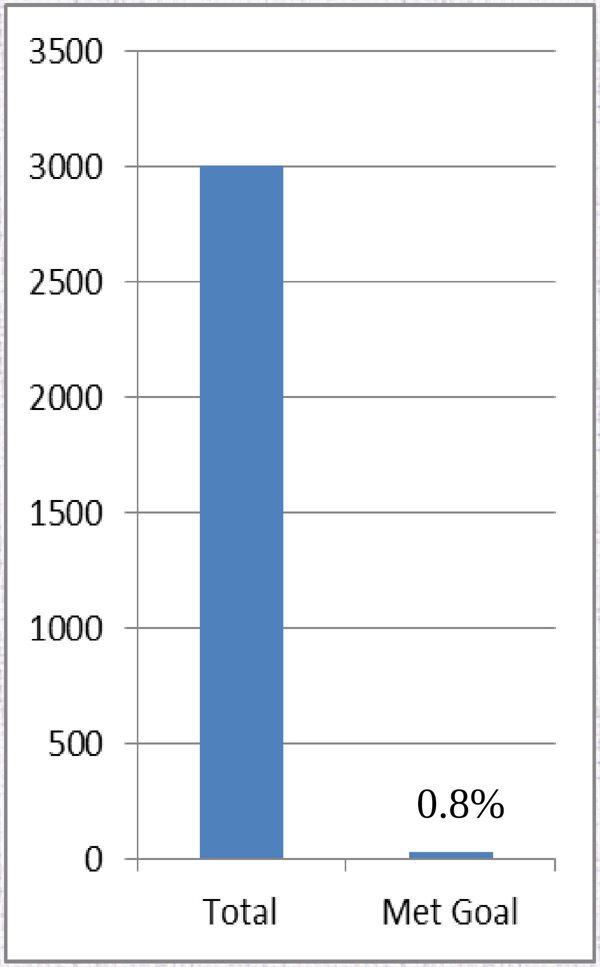
- Profit
- Return on investment
- Cash flow

pgt partners

Current situation

A Study by The Economic Times

- Studied 3000 actively traded companies on Bombay Stock Exchange
- Identified those which <u>increased their profits year on year</u> for 10 years

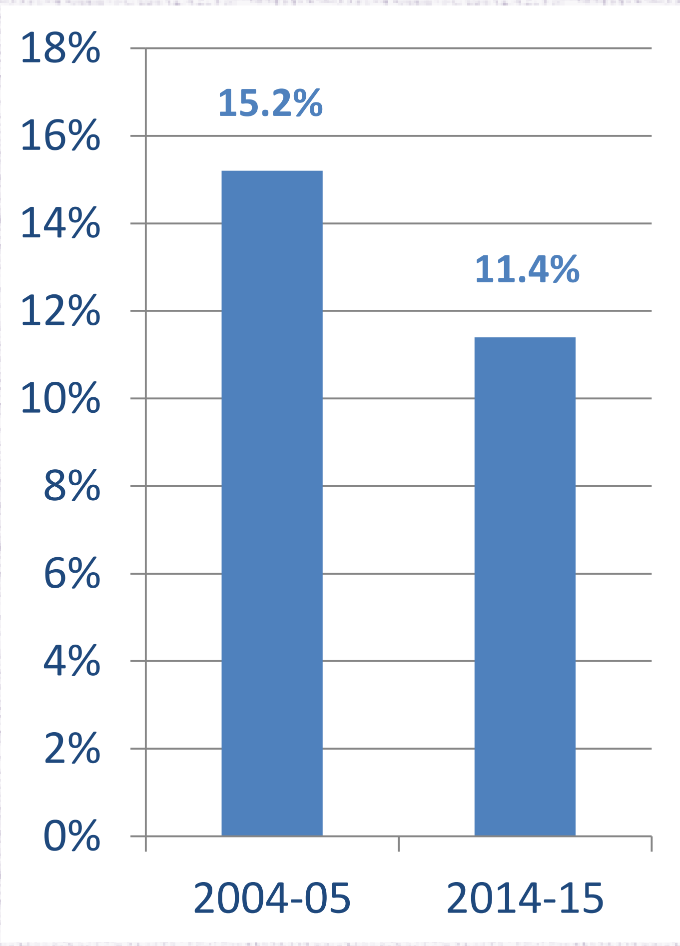


pgt partners

Current situation

Another Study by The Economic Times – 16.07.2015

- Studied a large base of manufacturing companies
- Studied the operating margin change between 2004-05 and 2014-15



pgt partners

Constraint for making money

- **Why** do organisations find it difficult to achieve the goal?
- **What** is that limits a business organisation in achieving its Goal of making more and more money?

pgt partners

How do we achieve results?

- Marketing and Sales
- Raw material
- Machine #1 … #2 … #3 … etc.
- Operators / Staff
- Shipping / Logistics
- Cash

The organisational situation

- Organisations face a huge amount of complexity in their value chain
- While looking for navigating this complexity and achieving higher goal units, the typical organisational response is to break the system into manageable parts, for example departments, production lines, product lines etc.
- This is perfectly all right as a way to organise and take specialised actions…
- …but it is **not the right way to set goals**.

pgt partners

Constraint for making money

The output of the organisation is achieved through the synchronised efforts of various functions.

What is present is the talent, the effort, the technology, the equipment, the distribution, etc but what is missing is the synchronisation.

pgt partners

Constraint for Making Money

Examples of Synchronisation Loss

Production	Hand Tools Forging
Purchase	Cold Rolled Steel
Design	Transformer Housing
Finance	Gear Manufacturer
Marketing	IT Services
Distribution	Power Tools Import

pgt partners

The organisational situation

- As discussed, organisations face a huge amount of complexity.
- TOC believes that within any complexity, there is an inherent simplicity that governs the results of the organisation.
- Let's see how to find this inherent simplicity and act upon it.

Simplicity is the ultimate sophistication - Leonardo da Vinci

pgt partners

Constraint for making money

What is the leverage point

Identifying WHAT to Improve and HOW to Improve

Section 3

What to Improve and How to Improve

Organisation as a chain

- An organisation can be compared to a chain.
- The activities that constitute a business are a ‘chain’ of dependent events.
- For example we do not dispatch components unless they are packed, and we do not pack parts until they are manufactured.

pgt partners

The Chain

- What determines the strength of a chain?
- How can we improve the strength of a chain?

Organisation as a chain

- The strength of this chain of business activities can be improved by identifying the weakest link and then acting upon it

- This requires viewing the organisation as a whole and identifying the areas to act upon

pgt partners

The Organisation as a Chain

- In reality we do the opposite and create an abundance of local measures in every department like efficiency & utilization, tons of production, sales turnover, material cost savings, total interest cost and so on because we believe that they are linked to NP or ROI.
- In effect, we start improving each link of the organisational chain in the belief that the global performance improvement is a sum of the local improvements. Just like a real chain this does not do any good, and can often be harmful.
- This is the error which constrains us from making more and more money!

pgt partners

Theory of Constraints (TOC)

- The core idea in the Theory of Constraints is that every system such as a profit-making organisation, *no matter how well it performs*, must have at least one constraint that limits its performance – this is the system's 'weakest link'.
- The theory also says that a system can have only one constraint at a time, and that other areas of weakness are "non-constraints" until they become the weakest link.
- Every 'for profit organization' will have a constraint in Supply, Operations, or Market. Current constraint may shift, but there cannot be any situation when there is no constraint. Had it been so, its profit would have been infinite!

pgt partners

Prevalence of Constraints

The constraints will determine the output of the system whether they are acknowledged and managed or not.

- There is really no choice in the matter
- Either you manage the constraints or the constraints will manage you.

pgt partners

Nature of Constraints

Constraints are neither good nor bad.

They are facts of life.

How does TOC help companies

- Focusing improvement efforts where they will have the greatest immediate impact on the bottom line.
- Providing a reliable process that ensures follow through.

pgt partners

Constraint Identification

- **Market**
  - Have > 50% of world market share
- **Orders**
  - Consistently deliver > 95% On-Time In-Full (OTIF)
- **Suppliers**
  - Pay consistently on time (>95%)
  - Consume > 50% of world consumption, and
- **Cash**
  - Unable to pay suppliers on time
  - Suppliers will supply only on upfront payment
  - Do not get material consistently on time (<95%)

Constraint Identification

- **Operations-Capacity**
  - Raw material is available consistently on time (>95%)
  - Overall Equipment effectiveness (OEE) for at least one equipment > 90% on 24x365 basis

- **Operational policies**
  - Raw material consistently available on time (>95%)
  - OTIF<95%
  - Overall equipment effectiveness (OEE) for no equipment > 90% on 24X365 basis

pgt partners

Constraint Identification

- **Owner's Hunger / Ambition**
  - In our experience, 95% of the time the organization performance is constrained by inetrnal policies
  - Owners / decision makers justify non achievement due to external factors (recession, unfair competition, government policies, employees etc.)
  - The real constraint is lack of ambition in owners/ decision makers, and, perhaps, fear/discomfort with making changes
  - No big performance increases can be done in this environment

pgt partners

A process of on going improvement (POOGI)

1. Identify the constraint.
2. Exploit the constraint
3. Subordinate all policies, decisions and procedures to exploiting the constraint.
4. Elevate the constraint. If we need still more output from the constraint, elevate it.
5. Avoid inertia. If in a previous step constraint shifts, start the cycle once again.

pgt partners

POOGI - Sequence is the Key

FIRST

- Be aware of what the constraint is and
- Choose the logical place where you would like it to be

SECOND

- Get the most you can out of it
- Subordinate all other activities to it

ONLY THEN

- Add capacity and/or diversify products/markets only when <u>absolutely required</u>

MAINTAIN CONSTANT VIGILANCE

pgt partners

Section 4

Implemented case studies from India

Case Study – Needle Bearings

Background


- Product
  - Needle Bearings in tie up with world leader
  - Market 70% Auto OEMs and 30% Replacement
  - Industry dominated by one company with 60% share
- Issues in Replacement Market
  - 25% share in OEMs but only 10% in replacement → Scope to grow
  - Sick company → Need to grow
  - Product quality and delivery good, price 10% below market leader; brand not well recognised by mechanics
  - 90% market fed from Delhi due to Sales Tax rules
  - Market study showed mechanics rated market leader best in all aspects including price
  - Demand from sales force and distributors to change product features similar to market leader
  - **Constraint was in marketing elements and in sales policies**

Case Study 1 – Needle Bearings

Actions Taken – 4 Ps of Marketing

- No change in product
- Number of Distributors increased from 15 to 60
- Outstation dealers' business protected by equalising landed prices across India by a combination of levying surcharge in Delhi and giving discounts elsewhere
- Quantity based discounts / month-end discounts / year-end discounts abolished
- Position of 'best in the world' taken to build up brand
- Direct shop to shop promotion to mechanics to create 'pull' – innovative methods used to
  - Communicate brand position
  - Keep cost low

Case Study 1 – Needle Bearings

Results

- Replacement market sales tripled in 2 years
- Company turned around with this increase as well as simultaneous doubling of OEM sales

Case study 2: Auto component manufacturer

- Background
  - Manufacturer of automotive gears
  - Losing money for over 5 years
  - Action initiated for divestment
  - Constraint: Operational policies / Financial Stress

- Actions
  - Stopped measuring “Tons”
  - All functional heads Key Result Areas (KRAs) abolished
  - Started measuring OTIF (On time in full)
  - Focus on throughput instead of sales
  - Weekly review

pgt partners

Case study 2: Auto component manufacturer

- Results
  - Throughput increases by 70% within 2 years
  - New gear manufacturing company acquired

Case study 3: Hospital Sterilizer Manufacturer

- Background
  - Manufacturer of hospital sterilizers
  - Losing money for many years
  - Constraint: Operational policies / Cash Flow

- Actions
  - Stopped starting new sterilizers without “Full Kit”
  - No more than 3 machines on the floor
  - Focus on throughput instead of sales
  - Weekly review

Case study 3: Hospital Sterilizer Manufacturer

- Results
  - Throughput increases by 25% within first 3 months
  - Lead time promised to customers reduced from 3 months to 2 weeks
  - OTIF increases from 5% to over 95% even with reduced lead time
  - Bank borrowings reduced significantly
  - Profit increased by 5 times in 1 year

Many Indian Cos. Have Implemented TOC Successfully. Would you like to:

Section 5

Summary

Summary

- A company must know its Goal.
- Then it must identify the Constraint(s) that is limiting the level of achievement of that Goal.
- Implement POOGI
- Ensure the whole team knows the goal and how the scoring is done
- The Theory of Constraints is about
  - Focus on global improvement in place of local improvements everywhere.
  - Process of On Going Improvement.

pgt partners

Thank You!

Vinay Agarwal
vinay@pgtpartners.com

www.pgtpartners.com
www.goldrattindia.com
www.tocinstitute.org

Mobile: +91-8130888111