

## The Skinny on Lean Management

By Richard Schonberger

Publish date: January 2009 Superfactory <a href="http://www.superfactory.com">www.superfactory.com</a>
--

Reprinted with permission.

Lean management doesn't resonate in marketing and sales. Nor does it among boards, senior executives and investors. Reasons relate to where lean tends to do most of its work - in operations - and its usual presentation as an attack on waste. Obscured are its much greater potential in the distribution pipelines and its strong customer focus.

What lean does, above all else, is provide quick, flexible response to customer demand. But muddling that message are perverse accounting practices that discourage quick delivery well matched to customer usage. Marketing's valued role is in collaborative lean planning, first within the company and then taken to customers in the external value chain.

### Getting Lean

There are various ways to get slim and justifications for doing so. The lean community tells us the way to do it is to cut waste. Moreover, in marketing's view, it should stay there. From its perspective, being slim suggests meager supplies of product to sell and a skimpy budget for selling them.

Further, we are told that reducing waste is not only lean's methodology, but also its objective. The reasoning sounds circular: Lean reduces wastes in order to reduce waste.

To gain traction, lean needs to present itself broadly and correctly. Its mandate, providing flexibly quick response, translates into fewer back orders, higher availability of what's selling and fewer gluts of unpopular product models.

Lean's customer focus once was well understood. When its basics were unveiled in the early 1980s, lean (formerly just-in-time) quickly became the rage in Western industry. With JIT, Japan had shown an amazing ability to mop up via speed, flexibility and quality - and at a lower cost.

Why the shift towards lean as an attack on waste? Three reasons: Waste reduction is easily taught, lends itself to measurement and does lead to quicker response. But so do other methods, among them simplifying product designs; culling lesser, capacity-gobbling products, components, suppliers and customers; and collaborating up and down the value chain. But all methods are hampered by how conventional accounting distorts decision-making.

### Lean Costing/Pricing

Accounting treats inventory as an asset. And it is - if the right product at the right time, and if processed and delivered with dispatch. Under lean, inventory reduction occurs only as causes of long, problematic lead times and resolved so that right items and quantities can flow both smoothly and quickly.

Of greater concern are accounting's averaging methods: Long lead-time specials get under-costed and priced, while standard models get the opposite. Companies lose money both ways.

Activity-based costing provides partial redress. It assigns extra costs, and the accompanying higher prices, to products/orders bogged down in engineering, the supply chain, production or in transit to paying customers. High-volume items, blowing past much of the overhead organization and through cellular production modules, benefit from lowered costs and prices.

Sometimes pricing practices annul lean's benefits. Back in 2000, new CEO Donald Washkewicz identified the cause of Parker Hannifin's mediocre financial performance: Parker's mark-up pricing, commonly 35%. "No matter how much a product improved," said *The Wall Street Journal*, profit margins were unchanged. When costs were cut, Parker "ultimately cut the product's price as well." Lean and other improvement initiatives hadn't a chance. Parker's new, competitive pricing is based on such factors as quick response, quality and uniqueness. Sales, return on investment and share price have soared. Inventory turnover, long stuck at about 4.0, has risen year by year - in 2007, up to 6.5. Parker's enlightened pricing might be expressed simply as:

- Raise prices on (or back off in promoting) complex, hard-to-make/provide products with long lead times
- Lower prices on (and/or promote and push) simpler, easy-to-make, quick-tim products

#### Bulging logistics pipelines

Outsized inventories in warehouses and transit should be lean's primary target. Many times, more inventory (and associated long lead times) reside there in factories. Operations may finger marketing for the glut, but globalization looks to be a weightier culprit. Ocean-spanning supply lines and shaky infrastructures increase what's in the shipping channels. Yet there is another, perhaps greater reason for un-lean supply pipelines. Again, it's accounting.

For all the talk about supply chain management, with cross-docking, RFID, pick-to-light and third-party logistics, the bloat persists. In-channel inventory is a hot potato, with neither party wanting it on its books. When user A pushes inventory back on supplier B, purchasing and finance at A smile, shake hands and say, "We've met our inventory turnover goals."

No they haven't. This is accounting gamesmanship. The reality - the excess inventory - is still there. If B produced it for A, then A owns it and its costs regardless of legalities, physical location and whose books.

The issue calls for finance, operations and marketing to jointly pin down the likely negative impacts of inflated inventory: carrying costs, slowed response to changing demands, reliance on age-deteriorating forecasts, costs of service recovery when a defect contaminates the whole lot and so on. Next is strengthening collaborative bonds between user A and supplier B. Along the way, A buries the performance metrics (accounting numbers and goals thereupon) at the root of the gamesmanship.

#### Practicing Lean - Jointly

Wal-Mart is the world's grand champion of lean supply chains. While advanced IT gets most of the credit, collaboration is the foundation. Wal-Mart's 2,000-odd suppliers near the retailer's Bentonville, Ark., headquarters maintain multifunctional teams on site. Daily, along with their Wal-Mart counterparts, they work out pricing, packaging, logistics, promotions, product options, product coding, weights and measures, sharing of actual and forecast demand data, and so forth. The on-site team from Acme Apparel or Widget Hardware must get itself together at home before it can present itself collaboratively with Wal-Mart.

Doing what's right requires a unified attack on the obstacles. There surely is no better unified than the chronically impatient customer. Lean - correctly defined, presented, planned and managed - directly responds to that impatience. It yields quick response all along the value chain, carrying along greater flexibility, better quality and higher value.

In lean's customer-focused mission and quest, waste is not the dominant target. Nor is waste reduction the sole or even the dominant methodology, but rather a valued enabler. Losing weight is not the aim of a good diet; improved health, increased capabilities and longer life more appropriately qualify. So it must be for lean.

Marketing 101 students are taught that the discipline revolves around product, price, place and promotion. Adding lean to the mix expands the arsenal, providing marketers with quick response, flexibility, quality and - collectively - value. Call it lean marketing.