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LEAN THOUGHTS

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Why Throughput Accounting

When I was managing an automotive parts company I could never understand how all the cost savings that were supposed to contribute to the organization never did get to the bottom line. I would get my accountant involved and we would check and double check the calculations but still no improvement to the bottom line. It was not until attending a management seminar when discussing this issue that someone asked "are you using the right measurements to determine which projects to work on?" Upon reexamination of our cost reductions it was obvious that we were very busy making improvements but none of the improvements were affecting the bottom line. From that day forward I always made sure that I was working on the right measurements. We see our business in 4 aspects: operations, products, process, finance and measurements. We have learned from the Japanese that we should always use the K.I.S.S. system. Significant improvements have been made in all aspects of our businesses with the exception of finance and measurements. Many manufacturing companies today are still using conventional standard accounting. This methodology has not kept pace with the requirements of the 21st century. It is too complicated and so few understand it. The information we receive does not allow us to identify, prioritize, and solve problems. Cost accounting assumes that increasing local efficiencies leads to maximizing the systems performance. As managers we are supposed to understand, over and under absorption. Inventory is an asset and if we build inventory we make money, but if we sell from inventory we lose money.

Cost accounting drives us to local optimization but this paradigm is **the largest obstacle to productivity improvement.**

What is the alternative: **Throughput Accounting? (TA)**

Throughput accounting is not a new concept the methodology has been around for ever we just did not know it had a name; in fact we manage our own finances using this methodology.

It is simple to understand and can be used by every employee to determine how to increase the value of the total system.

Throughput accounting is made up of three elements and based upon those three elements you will be able to differentiate between information and data to make good business decision.

Throughput: (T) The rate that the system produces money

Operating Expenses: Ongoing actual spending to provide operating capacity to convert Inventory into
(OE) \$ Throughput

Investment: (I) Money that is "parked" in the business for a period of time

Net Sales Sales less all money paid to outside vendors.
This will include all sales, production and tooling, less freight out, cash discounts, sales commissions

Variable Cost Direct material at standard, purchase price variance, outside processing, freight in, operating scrap (material only), external defects, obsolete and usage inventory.

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- EATON Cutler Hammer
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- ORENDA
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Where “Lean Thoughts”
Become Reality



Throughput = Net sales - Total variable cost
Note Throughput is not a measure of production it is only generated when sold

Operating expenses = All staff, production and non-production, Administration, Marketing costs, consumable, building costs. Only actual expenditures no variances.

Investment = Exists to provide long term capacity, or to be turned into future sales, inventory, machinery, facilities.

Managerial decision making:

When reviewing any business decision always ensure it will positively impact the bottom line or will prevent catastrophic failure, go through the following series of questions?

1. Does the project increase throughput and how?
2. Does the project reduce operating expenses and how?
3. Does the project reduce inventory and how?

Resulting measurements:

Net sales - Total variable cost = Throughput

Throughput / Operating expenses = Productivity

Throughput – Operating expenses = Net Profit

Net profit / Sales = ROS

Investment / Sales =ROI

If one or more of the above measurements has not increased it is not a good business decision.

Go back and review your current workload and I guarantee you will be able to eliminate a whole pile of projects that add no value. The ones that do survive, you will be able to prioritize into projects which give you the biggest bang for your buck.

Make sure that your measurements are geared to the system as a whole and not to local measures; an improvement in one department may cause additional costs in another. If we effect a capacity constrained department adversely a small savings in one department can cost us \$10's of thousands of dollars in lost business by jeopardizing customer relations through missed shipments or late launches.

Throughput account is counter intuitive to what we have always been taught, inventory is an asset, direct labour and operating expenses are variable and products have cost. We consume huge amounts of time producing an annual budget which for the most part the users don't understand let alone believe in then we are surprised when we don't meet our objectives.

Throughput accounting can help you look at you business in a different light and support your lean initiatives. It will focus your efforts on increasing the value stream and allow your whole organization to understand and measure your total enterprise for continuous improvement..

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Contact me if you need coaching or facilitation help in the areas such as but not limited to; 5S, Value Stream Mapping, Set-up Reduction, Problem Solving or Policy Deployment and Consortium Development



2008 Consortium Event Schedule



Tour Workshop Conference

January	February	March	April	May	June
<p>T</p> <p>Wednesday 16 <u>Eaton Electrical</u>, contact Joe Fisher, JoeRFisher@eaton.com</p>	<p>T</p> <p>Wednesday 13, <u>ACE Bakery</u>, contact Cindy Grolleman, cgrolleman@cebakery.com</p>	<p>T</p> <p>Wednesday 19, <u>Nestle Waters</u>, contact Mariela Castano mcastano@perriergroup.com</p>	<p>C</p> <p>Consortium Shareshowcase</p> <p>Saturday 05 <u>Eaton Milton</u>. Contact Cindy Grolleman cgrolleman@cebakery.com or Joe Fisher JoeRFisher@eaton.com</p>	<p>T</p> <p>Wednesday 14, <u>Alumicor</u>, contact Barry Wood barry@Alumicor.com</p>	<p>T</p> <p>Wednesday 18, <u>Morrison LaMothe</u>, contact Tony Vita tvita@morrisonlamthe.com</p>
July	August	September	October	November	December
		<p>T</p> <p>Wednesday 24, <u>Kraft Foods</u>, contact Hanif Jivraj hjivraj@Kraft.com</p>	<p>T</p> <p>Wednesday 16, <u>CTS Corp.</u>, contact Navneet Mann, navneet.mann@ac.ctscorp.com</p>	<p>T</p> <p>Wednesday 12, <u>Messier-Dowty</u>, contact Mike Smith Mike.Smith@Messier-dowty.on.ca</p>	<p>T</p> <p>Wednesday 10, <u>Orenda</u>, contact Brenda McIntosh brendamcintosh@orenda.com</p>