

BREAKTHROUGH

Lean Implementation & Training Resource Publication
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UNDERSTANDING VALUE

By Aaron Styles

Last month, we reviewed the common ways of understanding costs that are used in traditional accounting and business planning methods. Breaking down costs by category or by organizational function leaves out the most important consideration...**value**. And leaving out value almost always means leaving out the voice of the **customer**.

A Value-Added activity is any activity that changes form, fit or function of our product in conformance with customer expectations.

What would happen if we understood our costs in light of **value**? How might that change the nature of our continuous improvement efforts? In the simplest form, we would have,

Cost = Value-added + Non-Value-Added

Next, we must consider that there is some Non-Value-Added activity that is currently absolutely necessary. Let's call that Value-Aiding activity. Examples of Value-Aiding activities are the portions of logistics, accounting, purchasing, maintenance and other support functions which support the value-added flow of product. Also, if we wish to improve, there must be resources dedicated to continuous improvement. Finally, there are the resources and activities that do not fit into any of these categories and are not at all necessary. We'll call that waste. We adjust our formula as follows.

Cost = Value-added + Value-Aiding + Continuous Improvement + Waste

Every activity in a business falls into one of these categories. Now, here comes the interesting part. We must **earn** the right to reduce our cost. If we attempt to reduce our cost without earning the right, what happens? Imagine that we have 20% more labor cost than we can afford and still achieve our profit target. If we simply lay off 20% of the workforce, does the waste that those workers were "covering" magically disappear? Absolutely not. Will we reduce our value-added activity? No, that's what the customer is paying us for. Will we cut value-aiding activity? Not likely, it helps us get the value-add activity done. Will continuous improvement get cut? Most likely. For those who lack the determination to understand their costs in terms of value to the customer, the path of least resistance is always a good fit! In the short term, the difference is difficult to see, but in the long term when we cut our ability to improve, we have **mortgaged the future**.

Here's a drastic example. Suppose I need to lose 20 pounds. I could do the hard work required to diet and exercise, or I could simply cut off my arm. Would I lose the 20 pounds? Yes. Would I also lose the ability to do a lot of neat things efficiently? Absolutely! Arbitrary cuts usually result in undesirable, unintended consequences.

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Understanding Value, cont'd

Now let's add another perspective. Many are aware of the Covey Quadrants described by Stephen Covey in his book, The Seven Habits of Highly Effective People. They are as follows:

| <u>Quadrant</u> | <u>Description</u> | <u>Example</u> |
|-----------------|--------------------------|------------------------------------------------------------------------------------------------------------------------------|
| Quadrant 1 | Urgent/Important | Meet today's production schedule |
| Quadrant 2 | Not Urgent/Important | Reduce setup time in order to improve our ability to meet next year's customer requirements |
| Quadrant 3 | Urgent/Not Important | Fill out the production report our boss requires us to complete but never looks at and doesn't help us make additional parts |
| Quadrant 4 | Not Urgent/Not Important | Reading a comic book instead of understanding and responding to our problems |

In light of the Covey Quadrants,

Cost = Quadrant 1 + Quadrant 2 + Quadrant 3 + Quadrant 4

Note that Quadrants 3 and 4 are pure waste. Quadrant 1 is value-added and value-aided work. Quadrant 2 is continuous improvement.

When we understand cost in this light, it leads us to question everything. But we won't see these cost categories on a balance sheet. Join us next month when our newsletter looks at cost cutting in a new way, by eliminating wasteful activity in your environment.

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Since partnering with LMSPI we have experienced marked improvements in productivity, quality, and overall employee morale. Most consultant firms we have contacted in the past have suggested a solution with little or no input from the people that truly know the process (the front-line employees), or they have suggested a system that accommodates a lot, but not all of our product line. LMSPI took the time to dig into the process, understand it, and get feedback on proposed changes. They did not come in with a "canned" system, but designed and implemented a production system that fit our needs. The end result is a 95% reduction in work in process, and a visual plant that flows based on customer pulls.

Matt Hoover
General Manager

Stay tuned!

This is Part 2 of a 3 part series on cost. In next month's newsletter we will continue our discussions on cost and address earning the right to cut costs!