

The Data Looks Better From Far Away



In consulting with financial professionals over the past several years, I have noticed a recurring theme about the financial data they report and depend on. The theme is:

"The farther you are from where the data is collected, the better you think the data quality is."

This probably isn't easy to see by an individual doing a given job. But as a consultant looking at entire processes from both ends, it shouts out loud and clear after awhile. Let me give you a few examples.



Let's take manufacturing cost information-one of my favorite topics. I have often heard statements like, "The cost of our product is \$45.10 each." Or, "If you tell me how many of a product we will ship, I can tell you the profit for the month." These statements come from CFOs at companies with standard cost and low material content. Or, a sales manager who says, "I have to know the cost of the product, so I can price a deal." at a company that makes standard units. I've also seen instances where cost data is used to decide where to have a product manufactured.

These examples are very supportive of my "Data Looks Better From Far Away" thesis. In each one, an assumption has been made that (1) all the manufacturing costs are the same and completely variable, and (2) all the costs today will be the same tomorrow and down the road.

But if you are close to the data source, like a supervisor on the shop floor, you have to scratch your head at these assumptions. Why? Because there's a lot of activities observed first hand that simply don't appear to be in the cost calculation at all, and a lot of things seem to change ongoing.

First of all, the materials costs are based on purchasing who is making batch size decisions based onwell, who knows. They may be formulaic or just an ever-changing gut feel. Typically, they are based on lowest price, or on quality, or on who we have always done business with, or, or,... Is there going to be a set cost to this product?

Next, there is the "direct labor" cost. This may or may not include the material handlers, but probably doesn't include:

- The quality person.
- The supervisors.
- The expeditor (Oops, probably not a real job description, but there is someone doing it all the time.)
- The shipping/receiving folks. (And believe me, we couldn't make a product without them.....especially with that last batch of defective materials and their heroics keep manufacturing running.)

Third, there is the information about how machine set-ups are done. It is built into the cost based on some averages, but every day operations personnel are figuring out how to batch products and orders together to minimize set-ups as much as possible.

Fourth, there is the building and all the equipment that gets depreciated. Algorithms are used to spread these costs around. (But, they weren't updated last year because it took too much time.)

Even though the folks on the floor don't understand how the cost is put together, many do know a couple of things.

1. There's lots of "costs" not considered.
2. The more products we build, the less accounting will be on us, and that is a good thing (though the excess inventory can get in the way).

Somehow those employing unit cost-based thinking and decision making that are far from the data source and the personnel located where the data is collected have to start talking to one another. It probably won't be the easiest conversation at the start, because the base level assumptions about the information are so far apart. But, your company will continue to suffer from decisions made with false assumptions if the conversation doesn't start.

The easiest way to determine if you are too far from the data is by taking the two following steps.

1. Go spend a day in a plant. Find out who's doing what and where/if that work activity is reflected realistically or at all in the cost calculations.
2. Really think deeply about what kind of decisions you should make utilizing your standard cost information in order to supply the highest quality data to your company's decision makers.

As you look further into my thesis, you may find that simple numbers generated by a lean accounting perspective would address all the discrepancies presented above and much more. I like to call these "Real Numbers", and when widely applied, they can provide dramatic clarity to and expansion of the information picture throughout your company.

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