

Creating competitive advantage with supply chain performance

by Bruce Jacobs, St. Louis,
bejacobs@bkd.com

No longer can an enterprise's competitive advantage be defined by superior products. In fact, competitive advantage is quickly shifting to enterprises that provide the highest level of customer service and added value—on the customer's terms—through their supply chains.

Creating high-performance supply chains

Next to the brand equity and recognition your products and services achieve in the market, a supply chain that serves your customers at the highest degree will move your company to the next level of competitive advantage.

As supply chains compete with each other to serve customers at both the least total landed cost *and* the highest level of customer service, only those that perform the best will succeed and win the battle.

What does winning the battle of supply chains mean? It doesn't mean you survey your customers and make minor changes to close major performance gaps that allow your supply chain to provide mediocre customer service.

It means creating major breakthrough improvements in supply chain performance, *i.e.*, where the supply chain and all its business processes are focused on the customer and value-add activities that *serve* the customer.

The following characteristics receive high marks as value-add processes for high-performance supply chain capabilities:

- Quick response to inquiries
- On time and accurate order fulfillment

- Short lead times from receipt of customer order to delivery
- As product is consumed, customer receives "pull-based" demand replenishment
- Minimum inventories throughout the supply chain



Typical, executive-level mandated performance improvements attempt to increase supply chain performance but use the same old supply chain model and business processes that cannot perform above their current levels.

Set realistic performance criteria

The supply chain design you use now is only capable of delivering what it was *designed* to deliver; it will never outperform the highest level it currently achieves.

For example:

- 2.5 annual inventory turns
- 180-day net cash cycle
- 94.5% customer service level
- Slow revenue growth
- Orders have five- to eight-day lead time to the customer
- 120 to 130 days to reconcile invoice deductions and holdbacks
- 5% of customers on continuous replenishment

continued on page 2

Audit & Accounting News

Accounting rules clarified for overhead allocation

by Mike Wolfe, Springfield,
mwolfe@bkd.com

The Financial Accounting Standards Board (FASB) has issued Statement No. 151, which clarifies previous accounting rules about allocation of fixed overhead.

Fixed production overhead is generally allocated to inventory based on normal capacity, which the statement defines as a range of production based on normal operations over a number of periods, taking planned maintenance into consideration.

When production is abnormally high or low, abnormal amounts of facility and other fixed overhead should be reflected as period costs rather than as inventory costs.

Take care to evaluate the accounting impact of abnormally high or low production periods on overhead allocation.

This statement is effective for fiscal years beginning after June 15, 2005. ■



In This Issue

- Accounting rules clarified for overhead allocation
- EPA's tax incentives a boost for some manufacturers & distributors
- R&E state tax incentives gain momentum
- How to get your HR house in order

EPA's tax incentives a boost for some manu

by Gene Morgenthaler, St. Louis,
gmorgenthaler@bkd.com

In August, President Bush signed the *Energy Policy Act of 2005* (EPA), which includes more than \$14 billion in tax incentives designed to improve energy production, transportation and efficiency. Some are of particular interest to manufacturers and distributors.

New deduction stimulates energy-efficient construction

For manufacturers and distributors planning to upgrade a current facility or construct a new one, EPA contains a new deduction for expenses incurred in the construction of energy-efficient commercial buildings.

It also provides major incentives for building owners to upgrade their systems and—for those building new structures—to design them in an energy-efficient manner.

The deduction ranges from 60 cents to \$1.80 per building square foot but is only

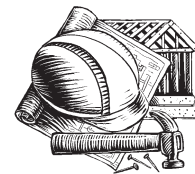
available if the property meets all the conditions below:

- Property is otherwise depreciated or amortized
- Property is installed on or in a building in the U.S. that is within the scope of Standard 90.1-2001 of the American Society of Heating, Refrigerating and Air Conditioning Engineers and the Illuminating Engineering Society of North America
- Property is installed as part of (1) the interior lighting systems; (2) the heating, cooling, ventilation and hot water systems; or (3) the building envelope
- When compared to a reference building that meets Standard 90.1-2001's minimum requirements, the property's installation is certified as part of a plan designed to reduce by 50% or more the total annual energy/power costs related to interior lighting systems, heating, cooling, ventilation and hot-water systems.

To the extent a building does not meet the overall building requirement of a 50% energy savings, a partial deduction is allowable for each separate building system that comprises energy-efficient property.

In addition, it must be certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by the Internal Revenue Service (IRS). The maximum allowable deduction is 60 cents per square foot for such a separate system.

The deduction generally may be claimed by the building owner unless the property is installed on or in property owned by a federal,



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continued from page 1

But *winning* the battle means your supply chain reliably meets many of the same performance criteria documented in numerous industrial, trade and professional journals:

- 21 to 30 days of inventory in the supply chain system
- 99.5% customer service level
- 80% of your customer's volume delivered on demand and "pull" continuous replenishment
- 90% lead time reduction from receipt of a customer's order to delivery at the dock
- 1% invoice deductions and holdbacks
- Zero penalties for nonconformance to customer specification
- 6% to 11% revenue increase
- 7% to 12% total cost structure improvement
- 40% to 45% reduction in SKU (stock keeping unit) offerings
- 90% reduction in inventory obsolescence and write-off
- 30% to 40% reduction in space needs for warehousing

Tax Tips

R&E state tax incentives gain momentum

by Herb Hanselmann, Indianapolis,
hhanselmann@bkd.com

Federal research and experimentation (R&E) tax credits have been renewed and some state tax incentives are being added or increased. Are you aware of all the incentives your state offers?

Across the country, more and more states are considering enacting or have already enacted incentives for increasing expenditures that could benefit many manufacturers.

Your state may be among those considering ways to expand the R&E tax credit with the hope of encouraging innovation.

Credits are typically calculated as specified percentages of qualified R&E expenses. Qualified expenses are similar to federal definitions and include direct research labor, supply and consultant expenses.

Temporary Internal Revenue Service regulations provide that elections of the two largest members of a controlled group filing a consolidated return are deemed to have requested and granted consent to revoke an earlier alternative incremental research credit calculation method for the entire controlled group.

This change may give manufacturers an opportunity to increase the amount of available research credit by generating additional credit or allocating more credit to group members.

R&E tax credit study results

Office furniture - The R&E team scouted out \$192,000 in federal and state credits for this \$20-million manufacturer of computer-display office furniture. Savings included product innovations, coupled with process improvement costs.

Steel foundry - A \$10-million steel foundry benefited by the BKD team's visit, generating \$100,000 in credits related to process improvement activities. This illustrates how the credit can occur in basic industries where continuous efforts are made to make products better, faster and cheaper. ■

Manufacturers & distributors

state or local government. In such cases—and under regulations yet to be issued—the person primarily responsible for designing the property (in lieu of the owner) will be treated as “the taxpayer.”

The statutory provision requires the basis of the commercial property be reduced by the amount of the new deduction, which applies to property placed into service after 2005 and before January 1, 2008.

Energy Star program created

EPA also officially establishes the Energy Star program under the Department of Energy (DOE) and the Environmental Protection Agency. Energy Star identifies, labels and promotes energy-efficient products and buildings.

The DOE is required to create new energy-efficiency qualifications (criteria are currently being determined) for dishwashers by January 1, 2006, effective January 1, 2007, and for clothes washers for the same time frame.

New energy-efficiency qualifications for both dishwashers and clothes washers would again be required by January 1, 2008, effective January 1, 2010.

New credits available for manufacturers

EPA includes additional credits of interest to manufacturers:

- A vehicle tax credit worth \$250 to \$3,400 for hybrid or diesel vehicles, depending on the vehicle’s fuel economy. The hybrid

credits are available beginning in 2006, for up to 60,000 vehicles from each auto manufacturer, with the tax break phasing out over the year after the cap is met.

- Manufacturers of energy-efficient appliances made in 2006 and 2007 will receive tax credits that could benefit consumers in the form of lower prices for certain products:
 - ✓ \$75 to \$175 per refrigerator, depending on efficiency
 - ✓ \$100 for clothes washers that meet Energy Star criteria
 - ✓ Up to \$100 for dishwashers, depending on Energy Star criteria ■

Competitive advantage...

- 4% to 10% reduction in the cost of purchased items
- 35% to 60% reduction in working capital requirements

Remember, executive mandated performance improvement is not systemic. It takes vision and courage to invest in longer-term, systemic improvements and business models that provide major business benefits.

Where to start

To make systemic performance improvements in your company’s supply chain, where do you start? First, imagine standing beside a customer at a product’s point of consumption. Then, look back through your supply chain to all the players and business processes that touch this customer.

Now focus on the activities that create value for your customer and eliminate the nonvalue-added activities that drive costs and inefficiencies. Did you know less than 2% of most business process activities actually add value in the same way your customers perceive value?

In redesigning your supply chain, it must reflect your *customers’* perception of superior performance. Envision how it must behave to reach that level and develop the strategy and business model(s) to help it get there.

Focus on all process lead times and every action or process that requires inventory. Lead time improvement with flawless execution of the business processes is the fastest method to achieving high performance in the supply chain.

To reduce process lead times, strive to eliminate nonvalue-add activities and complexity because both can add costs. Simplify, simplify and simplify to achieve the best practices for your business processes.

Ask the questions “why?” and “what should it be?” Assemble a cross-functional design team from your organization to challenge every process and practice. If an activity doesn’t add value, eliminate it. If you can’t eliminate a nonvalue-add activity, then simplify and automate it to reduce the cost of such activities.

Design and implement new performance measurements, those that measure the performance of the new business model and new business processes. Make your performance measurements visible and, if performance declines, make tools available to help improve it.

Calibrating benefits

For your supply chain performance to provide superior service to customers, it must provide superior service.

How large are the potential business

benefits in your enterprise? You can calibrate the magnitude of potential benefits. Consider the value of these items and determine their worth:

- One point of customer service improvement is worth how much more revenue?
- One day of inventory removed from the supply chain is worth how much working capital?
- One less day of order lead time is worth how much in competitive advantage, additional revenue and added customers?
- One percentage point of revenue increase over the current revenue base?
- One percentage point of total cost removed from the total cost structure?

Can your supply chain meet the competitive challenges today’s customers dictate? Can it help you win the battle against competitors?

As enterprises continue to compete, those with high-performance supply chains will succeed and win because serving the customer better with the least total cost and highest return on investment improves bottom-line performance. ■

How to get your HR house in order

by Sarah Farrell-Evans, Kansas City, sfarrell@bkd.com

One of the most significant challenges facing manufacturing and distribution companies today is finding and retaining skilled staff.

A prime source of high turnover for many companies is their failure to establish or articulate policies and procedures in a fair and consistent manner. It's also important that policies and procedures comply with often complex federal and state laws and accurately reflect a company's business strategy.

A human resources (HR) assessment can help your company evaluate how well its policies comply with complicated personnel laws and regulations, and it also can help identify areas that could pose a retention risk.

The critical areas an HR assessment generally focuses on include, but aren't limited to:

Employee handbook - Is your handbook comprehensive? Does it include required statements?

Hiring procedures - Do they comply with federal and state affirmative action guidelines?

Orientation training - Is it consistent with the employee handbook, and does it include required employee notices?

HR department operating procedures - Does documentation comply with the Equal Employment Opportunity Commission's

(EEOC) guidelines and the immigration documentation provisions under Homeland Security?

"Role" or job descriptions - Do they include the necessary competencies and background information to perform the job, and do they comply with provisions of the Americans with Disability Act?

Wage and salary administration - Do they comply with the exempt/nonexempt status provisions of the Federal Labor Standards Act, state wage-and-hour laws and the Family Medical Leave Act?

Performance evaluation systems - Do they comply with laws enforced by the EEOC and follow its guidelines for managing women and minorities?

HR records - Are your recordkeeping and file documentation in compliance?

In addition, HR assessments are designed to assess the compensation tools your company uses, including:



- Wage and salary administration issues
 - ✓ Adjustments to salary structure
 - ✓ Frequency and amount of salary increases
- Incentive and reward programs

- Retention bonuses and contracts
- Sign-on bonuses

A BKD HR assessment can help your company develop a specific action plan to address issues that could lead to high employee turnover or potential regulatory liability. Contact your BKD advisor for more information. ■

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P.O. Box 1900
Springfield, MO 65801-1900

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