



## **Lean: It Isn't Just for Manufacturing Firms**

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Most Los Angeles and Southern California business owners and entrepreneurs have heard of the concept of lean manufacturing, but many of those who own non-manufacturing businesses think that lean doesn't apply to their companies.

If this describes you, you should think again. The concepts that underlie lean manufacturing can be applied to any business, not just manufacturing firms. Putting lean principles to work in your non-manufacturing business can result in a number of benefits, including lower costs, higher productivity, greater efficiency, improved customer experiences, more innovation and higher profits.

### **Some Background on Lean**

In the 1970s, Toyota developed a new concept of manufacturing that came to be known as lean manufacturing, or just "lean" for short. This concept, which was tied to the Toyota Production System (TPS), was revolutionary at the time. Simply put, it redefined the traditional business model in terms of the relationship between price, cost and profits. The traditional model at that time was as follows:

$$\text{Sales Price} = \text{Cost} + \text{Profit}$$

However, the TPS formula changed the model to:

$$\text{Profit} = \text{Sales Price} - \text{Cost}$$

The difference is subtle but substantial. The lean approach recognizes that while sales price is set largely by the market, cost (and hence profit) is a manageable number that the business can control. That's why the lean approach starts with cost, which is controlled by the enterprise, and maximizes profit by reducing cost, rather than adding the amount of profit the market will bear to costs which have not been optimized.

The Japanese concept of "muda" forms the foundation of lean. Muda simply means "waste," which is defined as any activity or cost that does not add value to the end product and for which the customer is not willing to pay. It is relatively easy to spot "muda" in a manufacturing environment. For example, it would include activities like moving parts and semi-manufactured product from one location in a warehouse or on a manufacturing floor to another, or holding large amounts of inventory in the warehouse or on the floor.

There is a very real cost associated with these activities, even if it is not always obvious. The lean approach puts the burden on the enterprise to maximize profit by cutting all unnecessary cost. This is very different, philosophically, from other cost cutting approaches which simply seek to reduce existing costs, whereas the lean approach seeks to avoid costs by changing processes. The result is a different approach to business focused on how best to meet the customers' needs, not simply a focus on reducing costs. If this is done right, it also leads to higher profits.

## **“Muda” in Non-Manufacturing Businesses**

So what constitutes “muda” in a non-manufacturing business? What are some areas where there are wasteful activities and costs in non-manufacturing activities that do not add value and for which customers are not willing to pay? Here are a few areas where “muda” can be found in non-manufacturing processes:

- Accounts payable and accounts receivable processing
- Payroll processing
- Hiring, firing and other HR tasks
- Inventory management (retail)
- Transportation and logistics (other than shipping to the customer)
- Utilities and telecommunications
- Internal contract/documentation review and processing

You can probably think of many others. Simply ask yourself: “What things are we doing and/or what money are we spending on activities or anything else that do not add any tangible value as far as our customers are concerned?” If these things do not add customer value but they do add to your costs, you need to do whatever you can to make processes as efficient as possible and eliminate the waste in these activities — because it’s not logical to expect your customers to absorb the cost of your own company’s “muda.”

An outsourced CFO services provider can help you put lean practices to work in your company by helping you spot waste and then realign activities and apply technology solutions designed to reduce and eventually eliminate your “muda.”

## **Concluding Thoughts**

If you own a non-manufacturing business, you might not think that lean manufacturing applies to you, but think again. There are many potential areas of your company where you are wasting money and effort on activities that don’t add value and for which customers aren’t willing to pay. Operating lean means taking a hard look at your operations to identify and eliminate this “muda” in order to lower your costs, boost your productivity and efficiency and increase your profits.

## **About CFO Edge**

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