PRIVATE EQUITY PERFORMANCE IMPROVEMENT

8 Mistakes to Avoid During Footprint Optimization Initiatives

Introduction

The last three years have been a wild rollercoaster ride across global industries. Customer preferences shifted more drastically and more quickly than ever before, with certain markets suddenly experiencing significant demand increases and resulting supply shortages. From masks to flour and toilet paper to microchips, waves of specific consumer demand changes have created cycles of bottlenecks followed by overcapacities, which combined with difficulties in international and domestic shipping, security of supply, labor shortages and cost inflation have compressed margins.

As a result, many companies find themselves with the need to re-prioritize specific products, deal with idle capacity, and in general re-evaluate their cost structure. Manufacturing footprints and underutilized productive assets are an obvious and necessary target to recover and grow margins.

However, plant consolidations and other footprint optimization (FO) measures can be challenging and complex for any organization. From managing customer relationships to understanding available capacity, there are a multitude of factors that must be considered to ensure a smooth transition.

Based on A&M's experience, these are the most important and frequent omissions and mistakes organizations commit in this context:

1 Lacking Adequate Project Management Organization (PMO) Structures:

Are you are thinking about moving one program or a few SKUs from one plant to another? That may be a task that can be managed by existing program and plant management. However, many FO activities are much more complex in nature. Suddenly, you are confronted with a variety of multi-disciplinary issues. New suppliers must be found, employees have questions, retention plans need to be developed, new logistics lanes need to be established, data and systems need to be transferred and customer demands need to be attended to, just to mention a few. In the absence of a central figure to coordinate efforts, difficulties may quickly arise, and the project may lose momentum.

Case Study 〉 Food Industry Plant Consolidation

As an example, we encountered a client in the food industry who had tasked a plant manager with closing his own facility and transferring production to another. Unsurprisingly, for months, the client made no progress and conducted a series of additional studies instead. Once A&M was hired, a project plan was developed, project management (PM) was installed and the operations were consolidated within a few months.

Case Study 〉 Consumer Goods Manufacturing Merger

Another A&M client in the consumer goods manufacturing space was involved in a merger of two almost equally sized organizations. As part of the targeted synergies, the client planned to consolidate multiple facilities, taking around three years. For a complex situation like this, a PMO structure comprising client personnel, A&M's PMO lead, financial and analytical support and various functional leaders was required and established, which led to a successful execution of this extensive undertaking.

2 “Forgetting” Your Customers:

Losing the business of a large customer during a consolidation process poses one of the biggest risks to a company, potentially resulting in the loss of contribution margin from a large program and significant financial loss. To mitigate this risk, companies should carefully time the consolidation process and maintain confidentiality during assessment and planning to avoid alerting customers prematurely. It is also important to involve the sales force in managing the customer base and technical sales for product transfers.

At the same time, footprint optimization measures are a great opportunity to review your customer portfolio and shed customers whose volumes and margins don’t justify the support costs they require.

Case Study 〉 Medical Manufacturing Margin Study

As an example, one of our clients in the medical contract manufacturing space asked us to conduct a margin transparency study combined with an FO assessment. During this process, A&M was able to identify several programs for cancellation, thus reducing overall transfer risk and scope while saving several hundreds of thousands of dollars of overhead costs at the receiving facility.

3 Miscalculating Available Capacity:

Another risk in plant consolidations is overestimating the available capacity of existing and transferred assets. Before attempting the transfer of a major production line, it is critical to understand capacity and future volume requirements. What is demonstrated versus “nominal” production capacity? Where are the bottlenecks? In addition, it’s important to be aware that transferred production lines typically achieve their historical pre-transfer performance only after months of post-transfer training and finetuning.

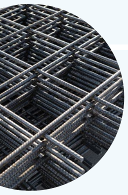
Case Study 〉 Food Preparation Raw Materials

As an example, one of A&M’s clients in the food preparation space assumed “nominal” throughput for one of their raw material preparation and fill lines. After the transfer, these optimistic assumptions did not match reality, and to make matters worse, the receiving plant’s supporting plant infrastructure was not sufficient to keep up with the increased demands. As a result, the client had to invest millions of additional dollars into updates but was still struggling to meet demand.

As a take-away, companies should invest their best effort into understanding available capacity pre- and post-transfer; the available plant utilities at the receiving sites should be evaluated and provisions need to be established to cover the costs of potential expansions or updates.

4 Neglecting Logistics Cost Impacts:

Logistics costs are often overlooked in plant consolidations, but they can have a significant impact on profitability. Companies must consider who will carry the outbound transportation costs — customers or the company — and whether customers might ask for pricing concessions in case they incur higher costs for pickup. It is also important to consider inbound logistics, including local access to crucial raw materials. This, combined with today’s capacity constraints in the trucking sector, make logistics an important cause of hiccups and mistakes.



Case Study 〉 Building Materials Consolidation to Mexico

A few years ago, an A&M client in the building materials industry was planning a consolidation of a plant in the east of the United States into one of their plants in Mexico. The Client considered the outbound logistics impact to be neutral based on the superficial observation that their top three markets were located at equidistant points from the original and Mexican target facility locations. After being asked to manage the planning and implementation, A&M proposed a detailed transportation study to better evaluate logistics impacts. Since markets ranked four to ten were in the Northeast of the U.S., the study showed that the resulting transportation cost increase would have eaten up around 70 percent of the planned consolidation benefits. Needless to say, the client's board was not happy. By optimizing the final location decision within Mexico and the logistics setup, A&M was able to "recuperate" around half of the projected transportation cost losses and the consolidation was implemented at lower, albeit mitigated, savings.

Frequently, transportation costs impact location decisions and consolidation of production activities considerably; any company undertaking such measures should put sufficient effort and resources into evaluating impacts on all aspects of logistics and transportation.

5 Underestimating the Hiring Effort:

Hiring the right people is crucial for the success of plant consolidations and transfers of operations, but it can be a challenge. Companies must be prepared to invest considerably in the hiring process, while also considering labor market conditions and competition for technical, skilled positions.

To put it bluntly, when it comes to hiring a work force, there are really just two things that can help: time and money. If you lack the former (i.e., need to start-up a facility quickly), you will have to invest more into the latter, which can negatively impact profitability of your future operations. Furthermore, if you consolidate into an existing location, hiring workers at greatly increased rates can lead to the need to adjust the wages of existing workers as well – a very expensive undertaking. Although a potential recession in the future might alleviate the current situation, the reality is that the U.S. and many international labor markets remain constrained in terms of skilled and technical labor.

Case Study 〉 Medical Manufacturing Labor Shortage

An A&M client in the medical contract manufacturing space operated several plants in the Midwest of the U.S. While the area provided a good pool of skilled and hard-working labor, due to recent expansion and growth, the ability to draw new staff into the plants was limited. The company found itself with several hundred open positions severely threatening future growth and the client's ability to serve customers. Consequently, the company decided to start up a facility in the South and undertook the considerable effort of qualifying operations and hiring personnel in an unknown environment just to secure sufficient capacity for future growth and customers.

Besides access to critical, local raw materials, or customers, and logistics impacts, the quality, cost and availability of the locally available work force should be the principal driver of any location decision for a new or expanded operation.

6 Skimping on Retention:

During the transition period, key employees are crucial for the success of plant consolidations; you need them available while the transfer is ongoing, and ideally, at least some of them should be willing to relocate to assure long-term success. Companies must identify these employees early on and offer them incentives and opportunities for relocation, thus providing the motivation to remain engaged and productive.

Case Study 〉 Building Materials Retention Budget

As an example, one of our clients in the building materials sector was planning a plant consolidation. Against our advice, they decided to reduce the retention program budget to around a quarter of total severance cost. When the time for implementation came, they decided to inform the plant manager of the impending closure, and just his retention package exceeded the budget allocated.

Cost of retention varies strongly based on the length of the transition period and the complexity of the operations in scope, but A&M has seen retention costs as high as 150 percent to 200 percent of the corresponding severance cost. While this seems high, a lot can go wrong during the transition period, which could lead to irreversible customer and revenue losses or quality problems; hence, retention and attention towards human resources are worth the investment.

7 Getting into Legal or PR Trouble:

No matter how well prepared and executed, and no matter how justified, a plant consolidation or production transfer never turns into a PR win. Employees' lives are disrupted, customers must adapt to change and suppliers often lose one of their customers. On top of that, several legal risks need to be addressed, ranging from employment and labor laws — such as the Worker Adjustment and Retraining Notification (WARN) and anti-discrimination laws — to contractual obligations based on the discontinuation of building leases and potential breaches of customer and supplier contracts. In addition, as applicable, rules for the past receipt of government subsidies might have to be broken. Lastly, expanding operations at the receiving or new facility might require additional environmental considerations, such as the checking of emission limits, requests for updated permits and more.

Consequently, A&M recommends budgeting for legal advice in the areas of labor, real-estate, contract and environmental law; in certain circumstances, hiring a specialized environmental agency to support the location search and evaluate environmental risk is advisable. The legal aspects of footprint optimization measures may lead to cost overruns as companies have not adequately budgeted for them.

8 Validating Issues and Quality Certifications:

In some industries, specifically the medical device, automotive or food industries, quality certifications and machinery or process validations are required before production can ramp up at a new location. While A&M has never seen a project fail because of these requirements, the amount of work required is often underestimated, leading to overextending demands on engineering and quality control (QC) departments as well as considerable transition delays. Companies must carefully evaluate the degree of customer exposure, which varies depending on whether they are an original equipment manufacturer (OEM) or a contract manufacturer, and ensure they understand the industry- and company-specific requirements. Very often, customers are not happy to support a transition and want to grab a portion of the projected savings as an incentive.

Depending on the specific situation, there are creative solutions that can improve the temporary strain. This includes using external metrological labs, hiring temporary engineering resources or asking resources at the closing plant to support the validation and start-up work, the latter being dependent on an adequate retention program. These factors share a commonality in that they drive additional cost; be careful not to underestimate the effort, time and cost of quality-related validation and certification efforts and budget accordingly.

Conclusion

In conclusion, plant consolidations can provide significant benefits for companies, but they require careful planning and execution to avoid the many risks and challenges involved. Companies must carefully evaluate all factors, from customer relationships to logistics costs, and invest in hiring, retention and quality certifications to ensure success.

That's where A&M comes in — we can provide a range of services and support to ensure that plant consolidations are successful:

Thorough Assessment: A&M can provide a comprehensive assessment of your existing operations to identify opportunities for optimization and consolidation. This includes reviewing your production processes, equipment, staffing and supply chains.

Checklists: A&M can provide checklists to help ensure that all critical aspects of the consolidation process are addressed. These checklists can include items such as developing a project plan, identifying key stakeholders, communicating with employees and customers and managing risk.

Implementation Tools: A&M has developed a range of implementation tools that can help streamline the consolidation process. These tools can be customized to meet the specific needs of your organization and ensure that all stakeholders are on the same page.

Proven PMO Experience: A&M has a proven track record of managing complex projects, including plant consolidations. We can provide the resources and expertise needed to ensure that your consolidation is completed on time, on budget and with minimal disruption to your operations.

Support from Functional Specialists: A&M can provide support from specialists in key functional areas such as plant leadership, procurement and logistics. These specialists can help ensure that all aspects of the consolidation are handled efficiently and effectively.

Industry Expertise: A&M has extensive industry expertise, including knowledge of best practices and emerging trends. This expertise can help ensure that all unique factors are taken into account and that your consolidation is aligned with industry standards and expectations.

A&M can help with all aspects of plant consolidations, from the initial assessment to final implementation. Our approach is customized to meet the specific needs of your organization, and we work closely with your team to deal with the inherent complexity and ensure successful completion.

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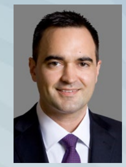

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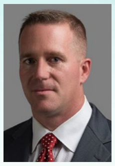

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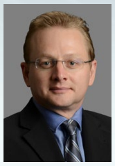

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With over 7,500 people across five continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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