The Manufacturing Leader

Perspectives for small and mid-size manufacturers

Personal Note:

From Rob Tracy

Welcome to Issue #2 of *The Manufacturing Leader* newsletter. This month we'll be introducing some new authors covering diverse topics, including sales planning, the benefits of a recapitalization, and prototyping.

This newsletter is in its infancy, and I'd love to hear from you. Is the content appropriate? Do you like the style? Do you like reading about a variety of topics in one newsletter? Is there another topic that you'd like to read about?

My contact information is at the bottom of the newsletter. Please reach out. I'd love to talk with you.

RobTracy

Recapitalization - an underutilized option for owners

By Shane Slominski

When thinking about succession planning, most business owners think they only have two options – they can either sell their business outright or continue to own and manage the business. There's a third option that isn't widely known but can be a great solution too: a recapitalization or a "recap" with a financial partner. A recap involves selling a majority interest in the business to a private equity firm, while retaining an ownership stake in the company going forward. In a recap, owners often sell 70-80% of the business and retain 20-30% ownership. For many owners, this solution provides the best of both worlds.

When do recaps make sense?

Recaps can be a great alternative to selling 100% of the business, and may be the preferred choice in several situations:

- The owner wishes to stay connected to the business. For many owners, the business is a culmination of a life of work, and a cold-turkey separation can be a white-knuckle emotional experience.
- The owner isn't ready to step away from being involved in the business.
- The timing of the sale doesn't feel quite right because the owner feels that there is still untapped potential in the business, and they may be selling too soon.
- There aren't successors ready to take over the business.
- The rate of investment needed to continue to fuel the company's growth is more than the owner wishes to make.

Benefits of a recapitalization:

Living through multiple cycles, including the 2020 pandemic, has caused many business owners to accelerate their timeline to pursue a liquidity event.

A recapitalization with an investment firm can provide an owner the best of both worlds. By selling 70-80% of the business, they obtain liquidity for the value they've created in the business. This gives them the opportunity to diversify their net worth in other investments, pay off the mortgage on their cabin, and set aside funds for future college expenses for children or grandchildren. They can continue to be the CEO or play a role they desire over the next several years to stay connected to the business. And retaining a meaningful ownership stake provides the opportunity to share in future value creation. This can be rewarding financially and usually has a defined time period, since an investment firm will desire an exit in a certain number of years, and the owner can sell their stake at the same time.

A new partner can also provide resources and capital to accelerate growth opportunities. This includes investments the owner may not have the appetite to make, such as additions to the team, sales expansion strategies, and add-on acquisitions. These investments can generate tremendous growth, which perpetuates their business and the second sale can provide another significant liquidity event for the owner in 5-7 years.

While not widely talked about, a recapitalization can be a great solution for business owners and is an opportunity to have their cake and eat it too.

About the author: Shane Slominski is a Partner at Tonka Bay Equity Partners, a Minneapolis, MN based private equity firm that acquires and invests in lower middle market businesses. Tonka Bay partners with business owners to realize liquidity events and works closely with management teams to execute growth strategies and build bigger, better businesses. Contact Shane at sslominski@tonkabayequity.com and learn more about Tonka Bay at tonkabayequity.com.

How To Set Your Sales Goals For 2021

By Mike Braun

This year certainly has had its challenges, personal or professional. But whether your company surpassed its sales goals or it struggled to stay afloat, you still need to figure out some way to set your sales goals for 2021.

Review Your Long-term Plan

You may want to consider throwing out your 3 – 5 year plan. Why? Because that plan was created with different information. The chances are that that information did not include a pandemic or economic downturn. You cannot just compare this year to last year because of everything that has happened. You also cannot base next year's budget based on this year

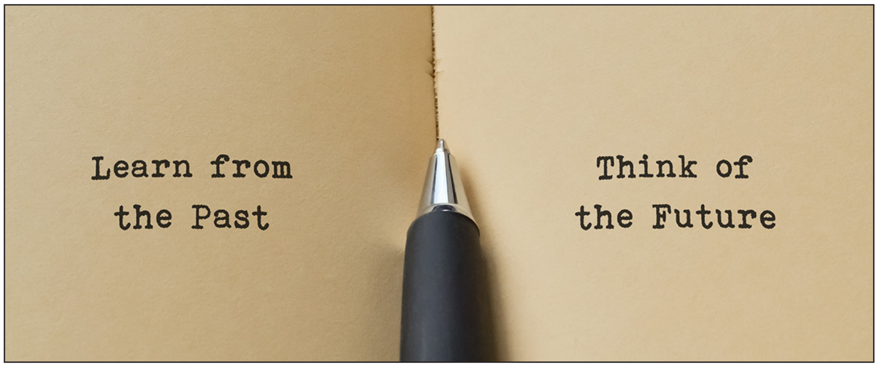
It's hard to tell where you'll be in one year, let alone five years from now. You'll have to be flexible when it comes to setting a plan in case you need to pivot abruptly.

Looking at Your Sales Trends

Start by looking at macro trends. A macro trend is a long-term directional shift that affects a large population, often globally. Such as government policy, economic cycles, climate change, and technology, to name a few. Look at the macro trends from 2019 to 2020. How did this year stack up to last year globally? Did it fall? By how much?

Then start analyzing your industry trends from last year to this year. Look at which industries have increased, and which haven't. Do you have any connection with them?

Next, look at your company's trends. What are your company's leading indicators? Look at those leading indicators and compare your company to your competitors.



Talk to other people within your industry and ask what they are seeing. Look at your accounts. You do not need to analyze all of them but look at the majority and determine what you are seeing.

These trends will help you get an overall view of how fast or slow things are coming back and where to get your goal.

Set Up Quarterly Goals

Once your 2021 total revenue goal is established, say at $12 million, set up quarterly goals as well. For example, set a quarterly goal for $3.5 million and then analyze if you are achieving that quarterly goal. Identify where the variances to plan are? If you are executing, find out what is working, and if you are not executing, then find out why not. Was it too much of reach, or did something happen outside of your control?

Make sure you have room to adjust and make changes when needed. Then follow up with your team at the individual level and see how they are executing and if they need to make adjustments.

Overall

To set your sales goal for 2021, you will need to analyze trends from all levels. Look at trends from a macro level, to your industry, to what you saw within your own company. Once you have your yearly sales goal, set up your quarterly goals, and be prepared to make adjustments.

Your 2021 sales goal may not be 100 percent accurate, but you'll be closer and well prepared when things shift unexpectedly.

About the author: Mike Braun is a founder and co-owner of Pivotal Advisors. A sales execution firm dedicated to building the best sales organizations on the planet. Over the past 30 years, Mike has had the opportunity to provide hundreds of organizations with methods and strategies to achieve consistent sales growth.

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Prototyping as a Profit-Center, not a Cost-Center

By Rodd Joos

What is your reaction when your customer requests a quote for prototype parts?

Traditionally, manufacturers consider making prototypes a cost of doing business. Customers expect you to support prototype quantities, but let's face it, they are a nuisance. Quoting the work takes as long as making the parts, and the order will not be worth much. However, you need to provide good service to your customers, and you hope that the prototype project will turn into a large volume order for you in the future.

Some manufacturers have focused on prototypes, though, and have made a profitable business from it. Those manufacturers have set up their entire business, from marketing to sales to operations to shipping to customer service, around prototypes.

Can a traditional manufacturer get into the prototyping business? Absolutely, but it requires a shift in thinking and approach. Pricing is one key element that must have a different, more courageous approach.

Customers tend to be in a hurry for their prototypes. A product developer is always under pressure to quickly release a new product to the market to generate more sales. New products, even enhancements to existing products, give the sales and marketing teams a reason to have a conversation with their customers about their products, brand, and company. Often customers looking for prototypes are more concerned about lead time than they are about price. Thus prototype parts should be priced based on value to the customer rather than your cost plus a gross margin markup.

To understand how to approach value pricing, think of it from the perspective of the customer. The customer's budget and buying decision for prototype parts are different from the budget and buying decisions for production parts. The funds will come from an R&D department (SG&A) rather than a COGS account. Lead time is of great value to product developers, and they are willing to pay for speed – not just when they are desperate but also when they recognize that the longer it takes to get a product to market, the less impact the product launch will have on their bottom line.

Customers will want a fair price, but a fair price does not necessarily synonymous with a low price. Charging for speed and responsiveness can be fair and acceptable to customers. Take overnight shipping as an example; freight carriers routinely charge 200% - 400% more for expedited shipping. In prototyping, the expedite multiples can be even more extreme. For example, in CNC machining, I have seen hundreds of customers routinely pay $500-$600 for a single part that would typically cost $25-$30 each at production volumes. Not only were they willing to buy at those prices, but many of those customers were delighted by the service and felt like they are getting more than their money's worth.

If you have been selling prototype parts too low and would like to turn that cost center into a profit center, you may be asked to justify the high price, especially from existing customers. This may seem like an obstacle, but in reality, it offers an opportunity to speak to customers about the value your quick-turn prototyping service brings and that it runs through a different process than regular production, which has a different cost structure.

Understanding the cost structure in prototyping is another aspect of prototype manufacturing that requires a different approach. That is a topic for another day.

About the author: Rodd Joos is a Twin Cities, MN based manufacturing professional with expertise in prototype manufacturing. He consults with industry professionals on the topics of prototyping and change management. Rodd can be contacted at rodd.joos@prototypeinsights.com.

If EOS® isn't right for me

By Rob Tracy

EOS®, the Entrepreneurial Operating System®, has become a popular system for entrepreneurial businesses. According to the EOS® Worldwide website, 80,000 companies have installed EOS®. For those considering EOS®, I recommend calling one of their professional implementers to learn more.

However, I am reaching out to the people that are NOT choosing EOS®. Despite its popularity, it isn't for everyone. Even the Toyota Camry, which is a fine automobile, isn't for everyone.

Some of the reasons that I've heard for not choosing EOS® include:

- It's over-simplified.
- It uses too much jargon.
- Parts of it don't seem to fit my business very well.
- It's too expensive
- It's too corporate sounding.
- It pushes us too hard and too fast.

These statements don't make EOS® a bad system, nor does it mean that EOS® advocates are wrong. It only means that for some people EOS® is not right for them. I'm typing this newsletter on a Macbook Pro. I love it, but I'm sure that there are many knowledgeable people that would criticize it for being a poor value, having limited ports, and being too heavy. No arguments from me, but I still love it, and it's not for them.

If EOS® isn't right for you, what should you do?

You could try to replicate the systems from a big-name company like Toyota or Danaher or look at other off-the-shelf solutions like Scaling Up (Gazelles / Rockefeller Habits). They all have their bright spots, but you'll need to tailor all of these to meet your specific needs, which leads to a key question:

Should you just build your own, custom-tailored operating system?

Implementing a custom operating system is a very viable option. You can create a system that is right for you. Put your fingerprint on it. Sign it and own it.

In order to build your own operating system, you just need to address nine key areas:

1. Strategy: How to create, update, and deploy strategy.
2. Profitability: How to manage profitability, including product rationalization, costing, pricing, and financial reporting.
3. Culture: How to define culture and live by it?
4. Organization: How to define roles, responsibilities, and structure for the organization.
5. Talent: How to prepare for the talent needs of today and into the future.
6. Performance: How to help people perform at a high level.
7. Improvement: How to plan and execute a continual improvement program.
8. PDCA: How to execute a plan-do-check-adjust cycle to manage issues in real-time.
9. Focus: How to keep people focused and aligned on the company's top priorities.

You won't need to start from scratch. Many companies and authors have pioneered effective solutions for each of these areas. You can choose the best-of-breed approaches that are the ideal fit for YOUR company. You probably already have some things in place that are working just fine.

You can also choose a budget that works for you. You can decide how much outside expertise and facilitation to use. The more self-sufficient that you can be, the lower the cost.

Summary

As companies grow, there is a need for increased structure and rigor, and the operating system creates the platform for future growth Whether you choose an off-the-shelf approach or a customized solution, the hard work is the implementation and sustainment. All operating systems will require your leadership.

If you're interested in this topic, give me a call. There is also more information about operating systems at my website: https://robtracy.net/operating_systems

About the author: Rob is a consultant that focuses on helping leaders of small and mid-size manufacturers to achieve their goals. He specializes in custom-tailored operating systems and strategic consulting. He can be reached at 651-398-9280, or rob@robtracy.net

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