Manufacturer

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To outsource or not? What manufacturers should consider

You can't do it all. That's what some manufacturers are realizing, and they're responding by outsourcing tasks ranging from equipment maintenance to customer service.

When done correctly, outsourcing can save manufacturers money and allow them to focus on their core business functions. But before you look elsewhere for help with your company's tasks, consider the decision from a strategic and financial standpoint.

Is it a core function?

The first question to ask is whether the task you plan to outsource is a key business function. Supporting tasks, such as human resources, customer service, marketing and shipping, are prime targets for outsourcing, since investing the time and resources to do them in-house generally doesn't enhance your company's value.

Even if the task you're considering outsourcing relates to your core business directly, outsourcing can give you a competitive advantage. As manufacturers struggle to keep up with shrinking customer attention spans, shorter product cycles and global customer bases, some are relying on outside vendors for engineering services or to produce a component of a product.

Outsourcing these functions can help manufacturers bring products to market more quickly, allowing them to capture customers' attention sooner and build a stronger customer base. Since staffing needs fluctuate during the product development cycle, tapping outside help, as needed, instead of keeping employees on staff also can save money.

Before committing to an outsourcing relationship, complete a thorough review of all the costs associated with performing a function in-house vs. outsourcing it.

Other questions to ask when deciding whether to outsource include:

- Does your business have the personnel and resources to handle a task in-house?
- How will outsourcing affect the finished product's quality?
- Will outsourcing compromise your intellectual property portfolio?

You'll also need to consider whether outsourcing a project will create too much reliance on the outside vendor in the long term.

Crunch the numbers

Before committing to an outsourcing relationship, complete a thorough review of all the costs

Get the most from outsourcing

You've made the decision to outsource — so now what? If you're ready to pull the trigger on outsourcing, here are some tips for getting the most for your money:

Shop around. Compare bids from multiple vendors before choosing one. Some vendors offer referral discounts or credits, so be sure to ask for one.

Read the fine print. Discuss the terms of your contract thoroughly with your business advisor, including deadlines, delivery dates and payment terms, to avoid surprises down the road. Have your advisor review the contract as well to make sure you're protected in case the relationship must be terminated.

Buy in bulk. Some vendors will give you a discount if you can promise a certain volume, or if you sign a multiyear contract. Bundling several services, such as materials procurement and production, into one contract can also help you save.

Provide detailed instructions. Whether it's a script for customer service representatives to follow or certain colors you want to include in your company brochure, give the vendor as much information as possible upfront to make sure you get what you're expecting.

Check in regularly. While you shouldn't have to hold your vendor's hand, it's a good idea to touch base regularly to make sure projects are progressing as planned and to head off any problems before they escalate.

associated with performing a function in-house vs. outsourcing it. Those costs can include labor, materials, software, rent and taxes. If you plan to outsource the task for multiple years, break down your comparison year by year, since items such as wages and taxes are apt to change over time.

When you're crunching the numbers, don't just compare your cost to perform the task internally with the amount that the vendor will charge. You also need to consider the indirect expenses of outsourcing, including having your attorney review the outsourcing contract, training the vendor, and investing time to schedule and coordinate the vendor's work.

You should also take into account sunk costs in your calculations. If you have a long-term lease for the building where your customer support team works, for example, you'll have to pay that rent even if you outsource customer service to another company.

Beyond calculating the direct costs of outsourcing a task, consider the indirect benefits that outsourcing may bring. Faster cycle times may allow you to charge more for a product because it reaches the market sooner, for example. If you're operating at capacity, outsourcing production also may free up employee time or equipment for other tasks, allowing you to ramp up production and boost profits.

Consider the risks

While outsourcing has its advantages, the associated risks also need to be considered. Contracting a task to someone else means reduced control over the end result, which can result in subpar work. Thus, make sure you hire a professional whose standards match your own.

Outsourcing, particularly to an offshore company, also leaves you vulnerable to problems within the vendor's company. Make sure you have a contingency plan in case your vendor is unable to complete its work because of bankruptcy or political turmoil in its country. Additionally, consider the cost of financing working capital to allow for longer lead times on international shipments.

A renewed focus

While manufacturers need to do their homework first, many find that outsourcing strengthens their companies by freeing up valuable time and resources. You may be unable to do it all, but outsourcing can make it easier for you to focus on what you do best. Discuss with your business advisor if outsourcing makes sense for your company. ■

Accuracy counts

Make corrections if your inventory counts are inaccurate

Using sophisticated inventory management software is supposed to solve the problem of inaccurate counts, but that's not always the case. Delays in order fulfillment and angry customers are inevitable if your warehouse is plagued by erroneous inventory counts.

If your inventory data doesn't match what you physically have in your warehouse, it's time to take corrective action.

Achieve accuracy

Unfortunately, there's rarely a quick fix to inaccurate inventory counts. Most likely you'll need to employ a multipronged solution. First, turn your attention to defining and mapping your work processes. Work with your staff to gain a comprehensive understanding of all steps that affect inventory.

Also chart the *actual* workflow and document how the processes *should* work down to the individual task level for each position involved in the process — from purchasing, receiving and stocking to order processing, fulfillment and shipping. This includes completing and processing paperwork, entering data through automated scanning techniques or manually at workstations, and performing any required monitoring checks for inventory.

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Next, ensure your employees are properly trained. Set up training sessions for all of your staff to review inventory processes and individual responsibilities. This will help them gain a solid understanding of workflow and how one process affects another.

Consider customizing your training so new employees receive more extensive training while more experienced employees receive periodic refresher courses as processes change. Test your employees on their knowledge of and ability to perform expected tasks, and provide constructive guidance for correcting errors.

The next step is to set realistic goals for minimum inventory accuracy. On a regular basis,

such as monthly, identify and report inventory inaccuracies — for example, improper counting, data entry errors, or goods lost to theft, damage or disorganization. Translate what these inaccuracies mean in terms of lost profit.

Finally, continuous improvement is a must. Regularly review your operations with your staff to pinpoint broken process areas and identify solutions for reducing errors. This will allow you to incorporate enhancements or new processes as business needs change.

Try to batch together several process improvements at one time to avoid confusing employees with multiple process iterations. Then roll out the changes through formal training sessions to ensure everyone is on the same page.

Implement cycle counting

To help you reach your inventory accuracy goal, be sure to include cycle counting. Cycle counting involves taking a physical count of part of your inventory in the warehouse each day.

These physical counts are then compared against the levels shown on your inventory management system. By pinpointing inventory discrepancies, cycle counting helps you identify the source of accuracy problems, so you can implement the right solutions.

To this end, there are two types of cycle counting that distributors need to employ in combination:

1. Control group cycle counting. This type of counting involves selecting a control group made up of a cross-section sample of inventory, including parts and materials, and then counting the control group and comparing it against your inventory management system data. Control groups are rotated according to an established set schedule to ensure that all inventory in the warehouse is counted at least annually. Because control group cycle counting should be performed at least weekly, it can help you timely identify the source of errors.

2. Random cycle counting. After you've implemented control group cycle counting, identified any sources of inventory accuracy problems and put the necessary solutions in place, begin implementing random cycle counting. With this type of counting, take a random mathematical sampling of your inventory to assess conformance against inventory accuracy expectations. An inference of the accuracy is then made relative to the entire inventory.

Cycle counting shouldn't be a one-time event. Conducted frequently, it will ensure continuing improvement in the accuracy of inventory.

Does it add up?

If inaccurate inventory counts are a problem at your company, you need to take corrective steps as soon as possible. Not taking proactive measures may result in a loss of customers and reduced profits. If you need help remedying inventory inaccuracy, contact your business advisor. He or she can help you ensure your numbers add up. ■

Smart strategies for paring payroll taxes

Can manufacturers reduce their payroll taxes without shedding employees? It may be possible if you implement certain strategies that can trim your tax burdens and boost your balance sheet.

Tax-savings strategies

Manufacturers must pay Social Security, Medicare and federal unemployment taxes, as well as state unemployment tax in most states, on their employees' wages. Collectively, these are called payroll taxes. Even if proposed payroll tax cuts are signed into law (check with your tax advisor for the latest information), payroll taxes still may take a big bite out of manufacturers' pocketbooks.

To reduce your company's payroll tax burden, consider these strategies:

Offer tax-exempt fringe benefits instead of more money. Even though you may want to reward employees with bonuses or raises, consider tax-exempt fringe benefits instead. You can deduct the cost of the benefits just as you would wages or bonuses, but you won't owe payroll taxes on them. Employees also won't owe income or payroll taxes on the benefits, and because they might otherwise have to buy these services with their after-tax wages, fringe benefits can also help their dollars go further.

Examples of tax-exempt fringe benefits include health benefits, education assistance, dependent care assistance, group term-life insurance, certain meals on the business's premises and retirement planning services. Dollar limits and exceptions apply to some benefits, so consult your financial advisor before launching a benefits program.

Establish an accountable plan for employee reimbursements. If you reimburse workers for mileage, tools or other job-related expenses, those payments generally are subject to payroll taxes. But by establishing an accountable plan, you can avoid owing payroll taxes on those reimbursements (plus they'll be excluded from employees' taxable income).

Expenses need to have a business connection to be included in an accountable plan. Employees also need to provide you with proper documentation for each expense, generally including an expense report and a receipt, within 60 days of incurring it. You can use the accountable plan to pay employees in advance for upcoming expenses, but employees must return any excess reimbursements within a reasonable timeframe, typically 120 days.

Bringing on independent contractors can save you payroll taxes because these workers are responsible for their own taxes.

Use independent contractors when possible. Bringing on independent contractors can save you payroll taxes because these workers are responsible for their own taxes. You must be wary, however, of the pitfalls that come with misclassifying workers. If you have too much control over a worker, the IRS will consider the worker an employee, even if you've treated the worker as an independent contractor. This could result in back taxes, interest and penalties.

Typically, a worker who completes work related to your core business is considered an employee. Manufacturers often use independent contractors for maintenance, sales or other noncore functions. Before engaging potential independent contractors for a particular task, evaluate the degree of control you'll have over the workers and look at how other manufacturers classify workers who do the same work. If independent contractor status is warranted, have workers sign an agreement stating they are independent contractors and responsible for their own taxes, and issue a Form 1099 to each one.

Ease the tax pain

In addition to these strategies, discuss with your financial advisor additional ways to ease the payroll tax burden. Payroll taxes are a part of doing business, but with a little planning they can be much less painful. ■

Winning the war on waste

Old pallets, used hydraulic fluid, process wastewater … it all has to go somewhere. Dealing with waste often is a costly and frustrating issue for manufacturers, but it doesn't have to be. Simple steps can help you minimize the waste your plant produces and manage waste more efficiently, greening your operations while also saving money.

To create an effective waste management program:

Avoid creating waste in the first place. Examine your manufacturing processes to identify ways to minimize waste and even incorporate waste back into production. If you manufacture clothing, for example, have workers lay out patterns using the smallest amount of fabric possible to minimize scraps. Paper mills and plastic manufacturers, meanwhile, may be able to add scraps to raw materials and reuse them in production. In addition, hone your inspection process to minimize reject batches. You'll not only cut down on trash, but also wasted time and effort.

Find new ways to reuse. One company's trash is another's treasure, so take the time to find new homes for your waste. If your waste includes valuable materials, such as metal, plastic wrap or cardboard, scrap processors will often pick them up for free or even pay you for them. Food manufacturers can also pass along their byproducts, such as wastewater and food scraps, to farms for irrigation and fertilizing.

Make your waste smaller. Even after reducing and recycling, you're likely to have some waste headed for the Dumpster. Since waste haulers usually charge a flat rate per load, fill your trash bins as efficiently as possible. Many manufacturers have industrial-grade trash compactors on-site to break down high-volume, low-weight products, such as wood crates. Look for a compactor that takes up the same amount of space as a pallet and that workers can operate without supervision. Along with saving on trash pick-ups, compacting your waste means you'll use less landfill space.

ABOUT HMWC:

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For more than 40 years, **HMWC CPAs & Business Advisors** has specialized in serving the financial and tax needs of privately-held businesses and their owners throughout Southern California. The depth and breadth of our experience — which includes such ancillary services as business consulting, business valuation, employee benefits and human resources services, estate planning and computer consulting — make us a valuable member of our clients' management team. At **HMWC CPAs & Business Advisors**, we are more than accountants, ***we are trusted business advisors***.

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