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Compensation packages: Finding the right fit

Are you struggling to pay rising health care costs, attract and retain skilled workers and comply with government regulations, such as the Department of Labor's overtime regulations and the shared-responsibility provisions of the Affordable Care Act (ACA)? These issues were among the top concerns reported by U.S. manufacturers, according to the third quarter *2016 Manufacturers' Outlook Survey* published by the National Association of Manufacturers.

To manage these issues, manufacturers may need to review their compensation packages and make some tough cuts. Here's a closer look at some of today's human resource challenges.

Trends in health care benefits

The Employee Benefit Research Institute (EBRI) is a nonprofit research institute that focuses on health, savings, retirement and economic security issues. EBRI recently compared health insurance benefits before and after the shared-responsibility provisions of the ACA went into effect.

The study revealed that larger employers continue to offer health insurance benefits to their workers. In fact, about 99% of employers with 1,000 or more employees provide health insurance benefits. The coverage rate among employers with 100 to 999 employees ranges between 93% and 95%.

> As the law currently stands, failure to comply with the shared-responsibility provisions of the ACA can lead to steep penalties.

But coverage among smaller employers has fallen dramatically since 2009. The coverage rate for employers with 25 to 99 employees fell from 81% in 2008 to 74% in 2015. For employers with 10 to 24 employees, the rate went from 66% in 2008 to 49% in 2015. And the coverage rate for employers with fewer than 10 employees decreased from 36% in 2008 to only 23% in 2015.

Reasons to provide coverage

There are many compelling reasons to offer health care benefits — and many employers will continue to do so even if the ACA is repealed or modified by Congress in 2017. The most obvious is that employers care about workers and want them to be healthy. Moreover, by offering affordable health care insurance coverage, your company may have an advantage over competitors in a tight labor market.

Help wanted? Consider hiring a veteran

Small business owners often struggle to find qualified workers. Some manufacturers are finding a good fit with veterans, who generally possess technical skills, a strong work ethic and resilience. Veterans also may have strong team-building and problem-solving abilities, because the military provides contingency and scenario-based training.

As an added bonus, hiring a vet may qualify your company for the Work Opportunity credit (WOC). The maximum wage that can be used to calculate the credit for hiring a qualifying veteran generally is $6,000. However, it can be as high as $12,000, $14,000 or $24,000, depending on whether the veteran is disabled, whether he or she has been unemployed, and the length of time he or she has been unemployed relative to the credit-eligible hiring date.

There's no limit on the number of qualifying new hires that you can take this tax break on. But *time* is limited: The WOC applies to qualified veterans (and other eligible individuals) who begin work for the employer before January 1, 2020.

On the flip side, as the law currently stands, failure to comply with the shared-responsibility provisions of the ACA can lead to steep penalties. "Large" employers that don't offer minimum essential coverage or that offer coverage that isn't affordable or doesn't provide minimum value face a penalty if just one full-time employee receives a premium tax credit.

Beginning in 2016, the full-time-employee (or equivalent) threshold for large employers is 50. For 2015, the first year that the provision was in effect, the threshold was 100 full-time employees (or the equivalent) if the employer met certain requirements.

Alternative cutbacks

To help pay for health care benefits, there may be other offerings that you can eliminate — or scale back. How do you know which benefits and perks your staff want the most? Compile a list of your current benefits, such as retirement savings plans, dependent-care and educational assistance, life and disability insurance, health club memberships, company picnics and holiday parties, summer hours, and free coffee and snacks. Then ask employees to rate their favorites.

Small changes, based on the needs and preferences of your workers, can save money without lowering morale. For example, a plastics manufacturer reduced benefit costs by 20% with three simple changes: It increased health insurance policy deductibles, decreased the number of retirement plan options and eliminated company-provided disability insurance coverage.

You can also substitute less conventional offerings if you need to eliminate a popular item from your benefits package. One idea is employee stock options, which preserve cash flow while giving employees the opportunity to purchase shares of the company's stock at a predetermined exercise price.

Another way to control labor costs is to monitor overtime hours. Limit nonexempt workers to 40 hours per week. If there's a rush order that requires overtime, require the plant manager to obtain preapproval from the company's CFO or owner. Whenever possible, consider using independent contractors or part-timers during seasonal peaks.

Make an informed decision

Many small businesses have gotten out of the health care game since the ACA was signed into law in 2010. But doing so can lower morale, make it harder to attract and retain skilled workers and lead to steep penalties. Before taking such a radical step, consider alternatives that can save money while continuing to offer health insurance coverage to employees. ■

Waste not, want not

Audit warehouse operations for inefficiencies

You can never be too busy to review how warehouses are laid out and how employees move around the space. Awkward or repetitive movements by employees, oversized packages and disorganized layouts can slow down productivity and even lead to medical and disability claims. Small adjustments can make a big difference in your bottom line. Here are three steps toward more efficient warehouse management.

1. Know your cycle time

Looking around the warehouse, you probably see a lot of people and products in motion. But don't equate constant motion with efficiency. A closer inspection may reveal people and products waiting in queues due to blocked aisles, unavailable forklifts or computer glitches. You may even find some workers wandering aimlessly for misplaced or hard-to-find items.

Improving efficiency starts by reviewing the order fulfillment process. Do you know how long it takes to process an order from start to finish? Your average cycle time is a critical benchmark. The goal is to find ways to reduce it by minimizing errors, wasted movements, congestion and inefficient picking paths. Bottlenecks, idle workers, unused space and piles of unattended inventory represent opportunities for improvement.

2. Implement improvements

Formal policies and procedures are an obvious way to reduce inefficiencies. Efficient warehouses have a specific protocol for putting away shipments of new items, restocking returns, cleaning up messes, responding to accidents and storing warehouse supplies and equipment.

Once those types of standard operating procedures are communicated to employees, focus on streamlining fulfillment. Examples of workflow improvements include:

- Rethinking floor, aisle and rack layout to improve space utilization,
- Rearranging product locations so the most popular items are located on ground-level bins that are nearest to the packing stations, and
- Redesigning signage to make it easier for pickers to identify aisles, racks, products, and workflow.

After you've implemented improvements, measure your new-and-improved cycle time. Knowing how much you've shaved off the baseline metric can be a powerful motivational tool. Use it to drive continuous improvement.

For example, a distributor was able to reduce its cycle time by 15% by allocating work to pickers based on units of time, rather than assigning a picker to fulfill one entire order at a time. This strategy keeps the pickers moving and feeds packing stations in predictable intervals. The distributor also assigned pickers to specific zones in the warehouse to avoid congestion and improve equipment availability.

3. Consider technology

Manual processes and outdated systems can cause errors and delays in fulfillment. So why not automate certain functions using technology? Bring your existing inventory management systems into the 21st century with upgrades such as wireless mobile devices, radio frequency identification (RFID) technology, automated material handling equipment and voice-picking applications. Doing so can potentially speed up fulfillment, reduce errors and enhance customer satisfaction levels.

Before investing in a technology upgrade, it's important to carefully weigh the costs vs. benefits. You'll also need to evaluate compatibility issues with your existing accounting or resource planning systems. Train employees on how to use the technology; otherwise, you won't reap all of its potential benefits.

Need help?

Sometimes objective outsiders with experience in the manufacturing and distribution sector can see warehouse inefficiencies that company insiders overlook on a daily basis. Or they may be aware of improvements that other companies have successfully implemented. Consult with your financial advisors before auditing your warehouse for guidance on best practices. ■

Use management letters to improve your business

Audited financial statements typically come with a surprise bonus that you might not be aware of: the management letter. Take a few minutes to review this letter. It generally contains advice on ways to make your business more efficient and profitable — and less risky.

What's required

Auditing standards require auditors to communicate in writing about "material weaknesses or significant deficiencies" that are discovered during audit fieldwork.

Material weakness. The AICPA defines this as "a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis."

Significant deficiency. This is generally considered less severe than a material weakness. It's defined as "a deficiency, or a combination of deficiencies, in internal control that is … important enough to merit attention by those charged with governance."

Auditors may unearth less severe weaknesses and operating inefficiencies during the course of an audit. Reporting these items is optional. However, they're often included in the management letter, or they may be reported to management verbally.

Responses vary

Audit clients differ in their responses to management letters and verbal suggestions. Some ignore the advice, thinking that it's just a way to up-sell consulting services. Others take offense, thinking that the auditor is "grading" management's performance. But open-minded clients pay attention — and often reap substantial benefits.

Consider the manufacturer who embraced his auditor's recommendation to take advantage of early-bird discounts offered by suppliers. Last year's management letter pointed out that early-bird discounts could have saved the client $45,000 in the first quarter, based on the auditor's review of cash disbursements.

Instead of filing invoices by due date, the company's payables clerk now files them by discount date and pays them early when extra cash is on hand. The owner estimates this simple change saved the company roughly $100,000 in 2016.

Observant auditors may comment on a wide range of issues they encounter during the course of an audit. Examples — beyond internal controls — include cash management, operating workflow, control of production schedules, capacity issues, defects and waste, employee benefits, safety, website management, technology improvements and energy consumption.

A valuable add-on

Auditors see clients at their best and worst. They know problems that other manufacturers have experienced and how they solved them (or not). Why not take advantage of the industry knowledge and objectivity that your auditor team brings to the table? In the end, you might discover that the management letter is the most valuable part of the audit process. ■

Valuation basics

What you need to know before transferring ownership

Over the next 30 to 40 years, recent studies estimate that as much as $30 trillion in wealth will transfer to the next generation. Much of this wealth will come in the form of private business interests.

How much is your business worth? That's important information when deciding whether to transfer ownership to the next generation — or whether it makes more sense to sell the business to a third party and give the next generation the sales proceeds (or alternative investments purchased from those proceeds). Here's a closer look at business valuation methods and the current state of the merger and acquisition (M&A) market.

Sanity check

A well-known rule of thumb for valuing manufacturers is five times earnings before interest, taxes, depreciation and amortization (EBITDA). But many businesses sell for more (or less) than this average.

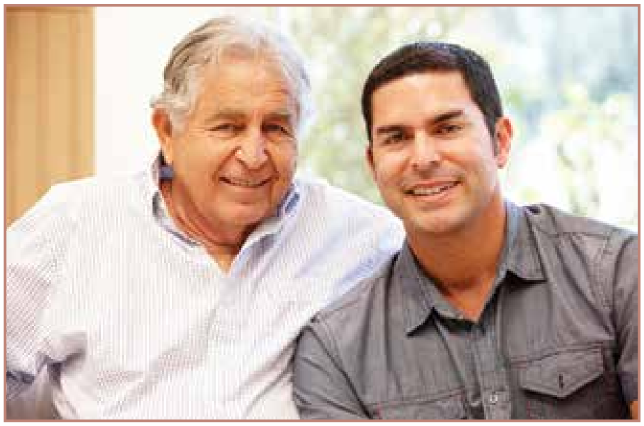
This oversimplified formula can serve as a useful sanity check for a purchase offer. But you shouldn't rely on it alone when selling your business, because it's arguably the most important business decision you'll ever face.

Instead, valuation professionals generally consider three tried-and-true valuation approaches to value manufacturers: the cost, income and market approaches.

Cost approach

Manufacturers rely heavily on tangible assets, so the balance sheet is a logical starting point. Some items are worth more (or less) than book value.

For example, real estate usually is reported at historic cost, but it often appreciates in value over time. Receivables also may need to be adjusted for bad debts. Inventory may include obsolete or unsalable items. And contingent liabilities — such as pending lawsuits, environmental obligations and warranties — also must be accounted for.



Another significant adjustment to the balance sheet is needed for intangible assets, such as internally developed patents, brands and goodwill. The cost approach generally omits intangible value, but it can serve as a useful "floor" for a company's value. Appraisers typically use another technique to arrive at an appraisal that's inclusive of these intangibles.

Income approach

Expected future cash flows can be converted to present value to determine how much investors will pay for a business interest. Reported earnings may need to be adjusted for a variety of items, such as accelerated depreciation rates, market-rate rents, and discretionary spending, such as below-market owners' compensation or nonessential travel expenses.

A key ingredient under the income approach is the discount rate used to convert future cash flows to their net present value. Discount rates vary depending on an investment's perceived risk in the marketplace.

Market approach

Sales of comparable public stocks or private companies may be used to value your business. Finding comparables can be tricky, however. Many small, private manufacturers tend to be "pure players," whereas public companies tend to be conglomerates, making meaningful public stock comparisons difficult.

When researching transaction databases, it's essential to filter deals using relevant criteria, such as industrial classification codes, size and location. Adjustments may be required to account for differences in financial performance and to arrive at a cash-equivalent value if comparable transactions include noncash terms and future payouts, such as earnouts or installment payments.

A seller's market

2016 was a strong year for M&A activity, and the conditions are right for the upward trend to continue. Many companies are sitting on large cash reserves, banks are offering relatively inexpensive financing options, and the U.S. political uncertainty is expected to calm down after November's elections.

With many potential buyers possessing the financial wherewithal to purchase your business, it could be easier to sell — and you could bring a premium if multiple buyers are interested in your business.

Value is the first step

Owners contemplating family business transfers face a tough choice: Should you sell now and take advantage of today's hot M&A market? Or should you transfer ownership to the next generation and keep the business in the family?

Answering these questions starts by valuing your business and examining current market data. Then you're ready to discuss future transfers with the next generation. A valuation professional can bring much-needed objectivity and experience to the planning process. ■

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