‘Pull or be Pushed…!’

- Lean Manufacturing and the Global Credit Crunch by Charles Johnston.

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The current economic climate has very few parallels in living memory. History suggests only 2 similar situations that can be legitimately compared to the current credit crunch in terms of the extent and depth; the Great Depression of the 1920s and the Oil crisis of the 1970s. In the first of these, the market decline lasted far longer than anticipated, partly due to the lack of understanding of the causes and partly the reluctance to reduce interest rates, whereas in the 1970s the inflationary effects were vastly underestimated, leading to a subsequent post-crisis inflation cycle.

Not since these historic times have we seen such a wide threat to global economic stability that we face at present. Indeed, it could be argued that the creation of the global marketplace has even added to the complexity of the situation; many industries, particularly the banking sector, are finding it difficult to identify their true risk exposure and this situation is also frustrating to regulators. Identifying the real extent of the crisis is a challenge and has undoubtedly prolonged the necessary ‘cleansing and recovery’ actions of many organisations. The ‘doom and gloom’ crowd who for so long have been warning of the effects of over-lending are now, maybe rightly, feeling very self-righteous.

Almost inevitably there will be more national intervention and tighter regulation of the credit markets in future. But this will not be debated in any serious way at the present time, for fear of adding to the existing banking woes and prolonging the depression in banking share prices, Governments are still craving stability after all! We may have however seen a peak of overall bank lending for a few years to come and clearly risk management will be more actively used by lenders as will wider variations in typical lending rates. At the time of writing, the threat of global stagflation (a period of rising prices, high unemployment and stagnant economic activity) has still not been fully discounted. Few market analysts are willing to predict beyond the forthcoming weeks with any certainty and the variation in financial forecasts has never been more marked.

Unprecedented global demand, particularly from the growth economies in the Far East, has led to highs in crude oil, steel, wheat and other commodities resulting in producer price increases which many businesses are finding difficult to pass on. As a result, margins are being squeezed and operating cost reductions more difficult to achieve, especially due to the economy of scale type production processes. Couple this with the potential increased cost of capital (or lack of) and businesses, particularly manufacturing, face some significant challenges ahead for the foreseeable future.

But the debate is raging about the real causes of the current situation; some argue about the previous vociferous lending of some banks creating a kind of 'banking peer pressure' - an atmosphere where risk was not really considered or was simply ignored; others blame banks chasing ever greater profits, over-leverage and the sustained use of complex financial instruments; could it be the increase in energy and Oil prices or a combination of this with commodity price rises; some argue that this is just another coincidence of business cycles. But whatever the causes perhaps more importantly what lessons can we learn from the current crisis and those of the past? Well, the term 'prevention is better than cure' springs to mind.

No doubt some preventative measures will be put into place in due course through legislation and these will go some way towards avoiding a reoccurrence; it has been suggested that some banks must be allowed to fail in order to reinforce the self-regulation of the industry which is often seen as potentially complex to achieve. The natural gas and crude oil price linkage will surely be re-examined and pressure will be put to bear on oil producers to review output quotas, but the debate is ongoing as to whether we will reach the 'peak oil' scenario by 2012 and this will undoubtedly have implications for OPEC and other oil producing nations.

Following the previous crisis of the 1970s, a great deal of research went into understanding why some organisations coped better and recovered faster than others immediately following such a crisis. This in turn led to a resurgence of interest in Lean and Total Productive Maintenance elements and the term World Class Manufacturing became very much the vogue. So how do World Class or lean organisations fair under such demanding market conditions and why do they have such advantages?

World Class is often referred to as a 'journey' rather than a 'destination' – there are always losses to eliminate and improvements to be made and this reflects the difference in their culture. It is not unreasonable to assume that no organisation can truly rest on their laurels and call themselves World Class. In fact, perhaps the true test of whether an organisation is World Class or not, maybe whether their competitors and customers believe they are!

Lean organisations operate in many different industries, from healthcare to manufacturing. Perhaps firstly it is best to point out one of the common misunderstandings of a lean business; a lean business is NOT JUST a business with low inventory. A lean business is a highly effective, efficient and responsive business with a very focused leadership and organisational culture geared to customer satisfaction and quality; a reduction in inventory is a natural result of being Lean through the elimination of over-production and the move away from 'mass production' type batch runs. Just because an organisation has minimal or no inventory does not make it lean as many organisations have found out to their peril. But an organisation that has eliminated over-production should by default, have minimal inventory.

Lean organisations, by necessity, have to be 'close' to their customers in terms of understanding of their needs. This is largely because lean organisations have eliminated inventory which would otherwise protect them from such vagaries in demand. The result is that changes in demand are quickly felt within the organisation and any measures can be taken as necessary within short timescales. Because there is no over-production the amount of capital tied up in inventory is minimised.

Many people confuse the means of becoming lean with such tools as 5S or Value Stream Mapping; and whilst these are undoubtedly powerful tools it is ultimately the ‘culture’ of the organisation that enables it to become Lean rather than the tools which it uses. Where some organisations fail is in their real understanding of this philosophical aspect. It is often said that the only truly common element amongst World Class organisations is that they have World Class people.

Many organisations believe that simply by implementing ERP systems they are on the path to success, and whilst no one can deny the power and usefulness of modern IT systems, a system for tracking stock in the factory is an additional overhead when compared to having no surplus stock at all. Many highly successful Japanese companies have extremely simple manual management systems largely based around Visual Management which negate the need for systems in the first place and this is just one source of their efficiency. In the Western world we have sometimes mis-understood the need to match people, processes and culture – by simply copying another process or system this does not necessarily mean the results will be the same.

The Japanese culture has traditionally been of life long employment and as a result organisations are able to concentrate on developing the employee and organisational culture safe in the knowledge that this is a sound investment for the future growth. Compare this with the Western trends in employee flexibility, conditions or employment, contracts and performance measurement and it is clear to see why many organisations by necessity use Employee Turnover as a KPI.

The true Lean approach is one of continual and constant improvement which can only be achieved through the engagement of the workforce and nurturing the organisational culture to create a zero loss mentality. This firstly involves an in-depth understanding and appreciation of losses; the application of leadership, tools and systems to deal with such losses; and process standardisation and knowledge transfer in order to sustain any improvements.

There is little doubt that the current global crisis is a significant challenge for government and businesses alike. A post-crisis world of higher cost of capital, higher raw material and energy costs and variation in demand will delay the recover of some businesses but the lean organisation will inevitably gain market share at the expense of others during this period. For the lean organisation, these difficult times are simply an opportunity to further refine the ways of zero loss thinking and increase market share!