Lean Accounting

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Companies that are seriously pursuing a Lean journey soon find their accounting, control, and measurement systems need to change to support the new strategy. The principles and methods of Lean thinking and practice are quite different from traditional business and require different measurements.

The changes are driven by both positive and negative needs. The positives include accounting, control, and measurement processes that support the new Lean strategy. The negatives are to eliminate the harmful impact of traditional accounting and measurements. There is a third change driver that is related to waste. While traditional companies often build increasingly complex and sophisticated accounting systems, Lean companies recognize their accounting and measurement systems need to be stripped down to the minimum amount of work.

Traditional Accounting Systems

Why are traditional accounting and measurement systems harmful to Lean? Traditional accounting and measurement methods are *not* wrong and bad. But they were designed to support mass production. Lean manufacturing is in many ways the *opposite* of mass production.

Traditional measurements like labor efficiency, purchase price variance, machine utilization, and others drive mass-production thinking. They lead to large batches, long lead times, high inventory, shortages, expediting, and crisis management. These are not bad measurements, but they are designed to support mass production and motivate mass-production thinking and actions. This is the opposite of what a Lean company is trying to achieve. If we are trying to make Lean change and improvements, these accounting and operational measurements will push back and stymie our efforts.

A very potent anti-Lean measurement is the overhead absorption variances. This also leads to manufacturing large amounts of products even when the customers have no demand for them. A recent academic study showed that the 2008 bankruptcies of General Motors and Chrysler Corporation were impacted badly by overhead absorption thinking. The car plants continued to manufacture "economic" order quantities, spending huge amounts of money, and making hundreds of thousands of cars that nobody wanted to buy—until the companies ran out of cash.

In a job-shop style production environment, these measurements and accounting tools are particularly harmful. The use of standard costs and margins leads to poor decisions. Decisions related to pricing, sourcing, make-buy, capital purchase, improvement projects, new products, etc., need to be made for the value stream as a whole. Decisions made related to the individual product or sales order will always be poor decisions.

A Lean organization—particularly a low-volume and high-variety—must eliminate these accounting and measurement systems and replace them with Lean Accounting methods that support and prosper thanks to Lean thinking and practices.

So What Are the Positives?

Lean Accounting has been designed to support Lean manufacturing (and Lean sales, Lean product development, Lean engineering, etc.). In order to do this, we need to develop accounting, control, and measurement processes that reflect Lean thinking and motivate Lean methods and action throughout the entire organization.

1. We focus our financial and operational reporting around the whole value stream rather than individual cells, work centers, processes, or departments.

We are not so much interested in the efficiency of individual departments or processes, but we are very interested in the productivity of value stream as a whole—the effectiveness and profitability of the entire system.

A value stream is all the things we do to create value for the customers. The starting point of all Lean thinking is an understanding of how we create value for our customers. And this value is created within the company's value streams. The value streams start from sales and go all the way through to purchasing, production, shipping, and cash collection.

Lean companies organize their businesses around the value streams that serve the customers. They create dedicated teams focused on a family of products or a market. And the team has a laser-sharp view of what must be done to increase revenues, reduce costs, increase cash flow, and grow their part of the business.

The job description of a value stream manager is:

- Create more value for the customer.
- Grow the business.
- Eliminate waste from every process.
- Make tons of money.

I was working last month with an aerospace component company in the U.K. where we have helped them develop a value stream organization. Even though they are in the pilot stages and have only created two value streams, their team members are wildly enthusiastic about the new arrangement. The operations director told me that he has been inundated by people in the company wanting to be included in a value stream.

2. Once an approach to value streams has been set up, then the financial and operational reporting is at the value stream level.

Traditional accounting is eliminated in favor of a simple, direct weekly income statement (of profit and losses). Instead of the complicated financial reports used by traditional companies, we create "plain English" income statements that everyone in the company can readily understand and use.

If you have timely and understandable financial information, then the value stream leaders and team members are able to make much better decisions, leading to growth, productivity, and profits.

Similarly with the operational measurements. The "vital few" measurements are produced weekly and visually displayed on the Value Stream Performance Board. These simple, timely measurements enable the team to drive continuous improvement every week based on real information everybody owns.

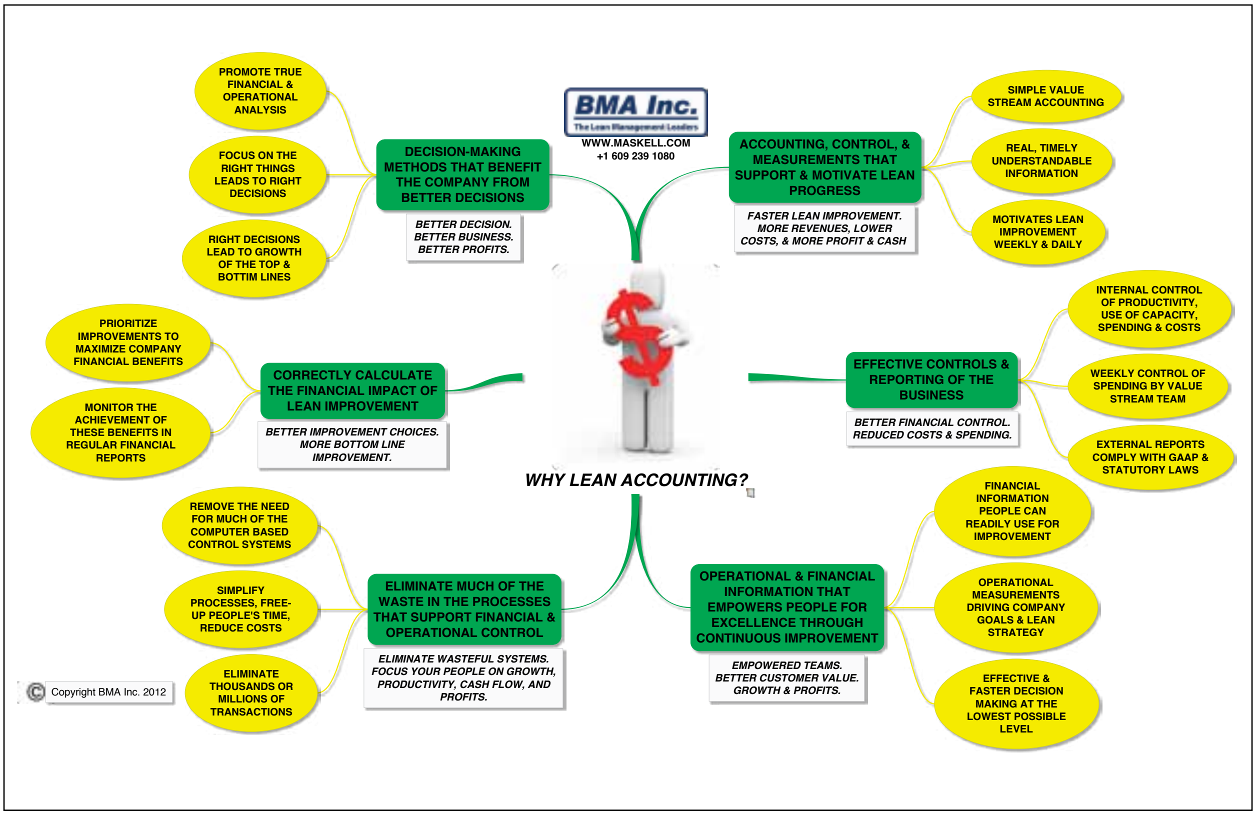
This operational and financial information is also used to work out the true financial benefit coming from Lean improvement. The Value Stream Accounting shows you the real, bottom-line savings and profitability of your Lean improvement efforts.

3. The value stream team members have a clear focus on the value created for the customers.

When we are organized in value streams, then all the team members have line-of-sight to the customers. When we know what the customers truly value and we know (and have full control over) the processes that create this value—then we can work step by step to increase the value, while at the same time reducing the costs. If you increase the value to the customers, then you can increase prices and/or gain unheard-of market share growth and customer loyalty.

4. Lean Accounting is a lot less work.

In Lean Accounting we have primary reporting at the value stream level. We do not need the thousands or millions of transactions required to maintain the departmental reporting, the labor tracking, or any of the other so-called control systems traditional companies anguish over.



There is a maturity path to making these changes. As your company becomes proficient with Lean thinking, your processes will come under control. Much of this control comes from pragmatic, visual tracking by the people in the processes. As your company makes more progress with Lean, you will get to the point where the secondary transactional control systems (ERP/MRP) are increasingly unnecessary and can be gradually phased down. Do not think that I am speaking against these ERP systems. They are valuable tools for any Lean company. But they are largely wasteful, and we need to eliminate waste from the systems as well as the physical processes.

We have a good number of customers that have a two-transaction factory. They use a transaction to receive materials and a transaction to ship the product. They have largely eliminated accounts payable and no longer track inventory. Not every company can achieve this, but this is the gold standard of transaction simplification.

Conclusion

As you begin to make progress with Lean manufacturing, Lean product design, Lean sales, Lean engineering, and Lean administration, it soon becomes clear that the traditional accounting, control, measurements, and decision-making systems are no longer appropriate. In fact, they are in many ways anti-Lean. The purpose of Lean Accounting is to provide the vital operational and financial information in a way that motivates Lean transformation and improvement—and is itself a low-waste and Lean process.

Brian Maskell will be discussing Lean Accounting at the Continuous Improvement Conference in Indianapolis, Indiana April 7–10. To register visit www.printing.org/ciconference.