

The Cost of Bad Job Costing

AND HOW TO FIX IT

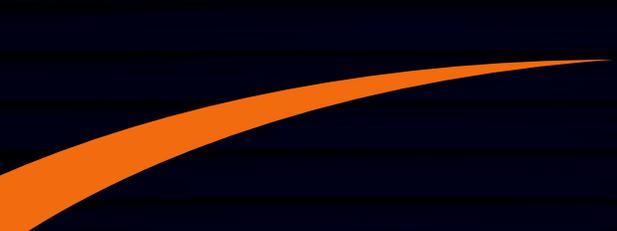
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If you struggle to accurately measure your job costs, don't feel alone. Job costing is one of the most complex and difficult tasks in a manufacturing business – especially in job shops where almost every job differs from the rest. Many manufacturers consider accurate job costing as their biggest challenge. Many who have mastered the costing challenge also consider it a major benefit of having an ERP system.

COSTING INVOLVES BRINGING TOGETHER A WIDE ARRAY OF DISPARATE ELEMENTS – FROM MATERIALS, FREIGHT, LABOR (DIRECT AND INDIRECT) AND OVERHEAD TO QUALITY, SCRAP, OUTSIDE PROCESSING AND MORE – TO PRODUCE AN ACCURATE PICTURE OF WHAT IT COSTS TO SHIP A FINISHED PART OR JOB OUT YOUR DOOR. COMING UP WITH THE PRECISE ACCOUNTING OF HOW MUCH IT TAKES TO PRODUCE A PART OR A JOB IS ALSO ONE OF THE MOST IMPORTANT TASKS IN MANUFACTURING, AS IT LAYS THE FOUNDATION FOR ESTIMATING, QUOTING, PRICING, SETTING MARGINS AND DEVELOPING COMPETITIVE STRATEGIES THAT DETERMINE THE PROFITABILITY (OR NOT) OF YOUR BUSINESS.

When you can't cost jobs accurately, it inevitably costs you time, money and customers. Estimating and quoting become uncertain processes based on guesswork rather than precise data. Inaccurate tracking of labor time drives up labor costs. Slow quoting can lose jobs to more responsive competitors, while overpricing puts you at risk of being underbid. You may think you're making money on a part or a job when you're actually sending it out the door for less than it cost to make.

Compounding the degree of difficulty is today's market requires costing to be a real-time activity, not a historical one. If you can't determine what each job costs (and why) as it moves through the shop floor, you'll always be a step behind any competitor who can.

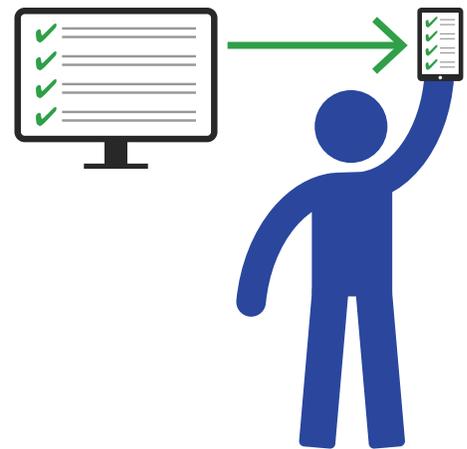
Turning Chaos into Control

As with many shop floor problems, poor job costing often results from outdated processes and procedures, including:

- Collecting direct labor manually
- Tracking indirect labor haphazardly, or not at all
- Poor inventory control
- Inconsistent purchasing processes
- Lack of **live production data** on the shop floor
- Inaccurate setup and breakdown times
- Failure to account for outside processing, expedited shipping and other peripheral costs
- Failure to account for one man running multiple machines or a machine running unattended

THE SOLUTION TO THESE AND OTHER COSTING PROBLEMS LIES IN HAVING AN INTEGRATED ERP SYSTEM THAT TRACKS YOUR COSTS IN REAL TIME.

The key word here is *integrated*, meaning all the modules in the ERP system talk to each other, so that when a critical piece of information is entered in one part of the system, it automatically populates throughout the rest of the system. When people on the shop floor and in the administrative offices have access to the same up-to-date data, they can make quick, informed business decisions to better manage costs and margins.



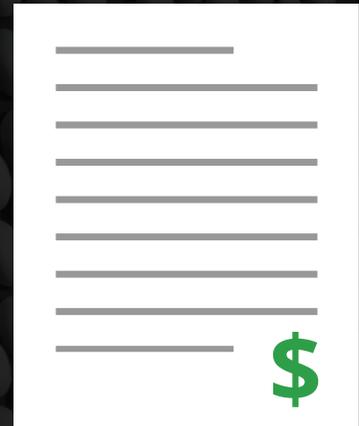
THE SOLUTION TO THESE AND OTHER COSTING PROBLEMS LIES IN HAVING AN INTEGRATED ERP SYSTEM THAT TRACKS YOUR COSTS IN REAL TIME.

With ERP, you can track job costs, margins and profitability – for every part, every job and every customer – with amazing precision. ERP allows you to measure direct labor costs for each job and job sequence down to the penny, while identifying and eliminating wasteful indirect time.

Material costs are tracked in real time as jobs move through the production process, allowing you to know the true cost of each job and each job sequence as soon as it is complete. You also know exactly what you have in inventory and what it cost, and can track variance as it occurs by comparing actual versus estimated costs while jobs are in progress.

FROM A COMPETITIVE STANDPOINT, KNOWING YOUR COSTS ENABLES YOU TO ESTIMATE AND QUOTE WITH PRECISION WHILE ENSURING MARGINS ARE WHERE THEY NEED TO BE.

Costs no longer disappear down the black hole as you **track and build costs for projects** that take months to complete. Perhaps most important, real-time costing helps enhance your competitive position by uncovering opportunities to drive cost out of your production process while maintaining margins.



KNOWING YOUR COSTS ENABLES YOU TO ESTIMATE AND QUOTE WITH PRECISION WHILE ENSURING MARGINS ARE WHERE THEY NEED TO BE.

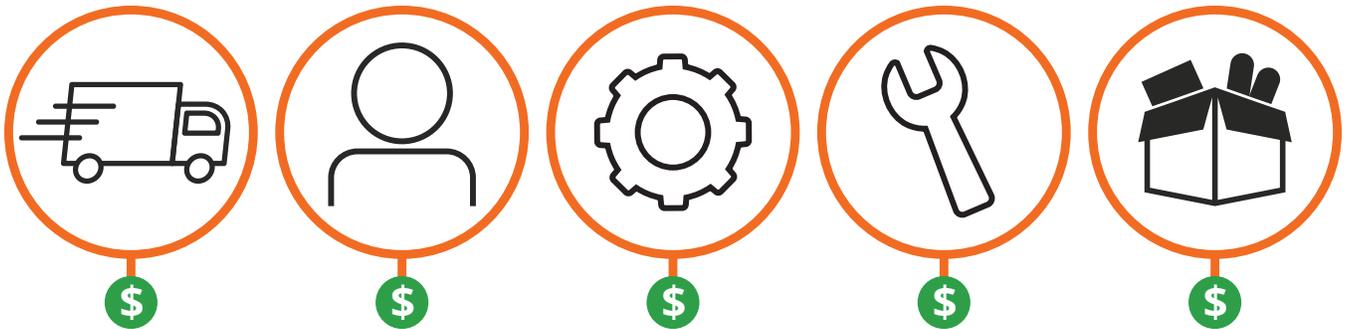
“We used to see where we stood on costs, margins and profits at the end of each project,” says **Jeremy Finney, Operations Manager for Arc Design, Inc.**, a custom manufacturer of parts for oil drilling structures. “With Global Shop Solutions ERP, we now track and control everything as we go along. When we complete a job, we know exactly what it cost, whether we made money, and how much. The ability to budget, estimate, and know what projects cost allows us to compete more effectively in our market.”

Unprecedented Costing Visibility

Like so many shop floor processes, the key to accurate costing is having access to the data. An ERP system provides this essential costing component by:

- **Collecting all your manufacturing data in one system**
- **Letting you see all your manufacturing in real time**
- **Keeping tabs on every stage of production**

Even with a good ERP system, determining how much individual components contribute to the total cost of finished goods can be a challenge. For example, individual costing components such as labor and materials often get lumped together when determining finished goods costs. When this occurs, it can be hard to pinpoint which cost components are at fault if the cost of goods sold begins to rise.

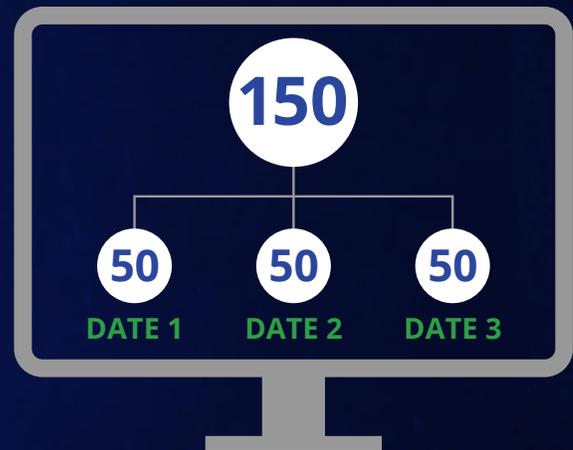


TO ADDRESS THIS ISSUE, YOUR ERP SOFTWARE SHOULD ENABLE MANUFACTURERS TO SEPARATELY TRACK AND MEASURE FREIGHT, LABOR, OVERHEAD, OUTSIDE SERVICES, MATERIALS AND OTHER INDIVIDUAL COSTING COMPONENTS WITH REMARKABLE PRECISION.

In addition to identifying the percentage of each cost component for work in progress, these programs also provide complete histories of every part that has passed through the shop floor. The ability to compare and analyze old quantities and costs with the cost of current transactions enables more informed management decisions.

“With our specialized ERP software, we can now tell how much labor and material went into a specific part, and how the cost breakdown compares with past production of that part,” says **Mike Zehentner, Vice President of Business Development for Kryton Engineered Metals**. “This allows us to identify how a change in production costs (such as an increase in material costs) will affect margins, as well as which processes can be improved to lower costs.”

Tracking all the cost elements of a job separately also allows you to identify the most efficient quantity at which to make a specific part. For example, suppose a customer orders a quantity of 150 parts, 50 each on three different delivery dates. Knowing the cost of each element, such as materials and setup times, enables you to determine whether it is more efficient to manufacture the part in three separate batches or make them all at once and hold in **inventory** for the customer.



YOUR ERP SOFTWARE SHOULD CALCULATE THE SALES PRICE BASED ON THE COSTS TO BUILD THE PART AND YOUR DESIRED MARGIN. IF THE MARKETPLACE DOESN'T ALLOW YOU TO HIT THE DESIRED MARGIN, SIMPLY PLUG IN A PRICE AND THE SYSTEM WILL DISPLAY THE MARGIN, ALLOWING YOU TO SEE WHETHER YOU WOULD MAKE OR LOSE MONEY ON THE PROJECT.

Compete on Cost, Not Price

Ultimately, the goal with precision costing is to develop the ability to compete on cost rather than price. Of course, every manufacturer needs to offer competitive pricing in order to compete. But when you compete on price without knowing your costs, you could be losing money on each job or leaving money on the table without knowing it.

WHEN YOU KNOW YOUR COSTS, YOU CAN DETERMINE YOUR MOST PROFITABLE PRODUCTS, PRODUCT LINES AND CUSTOMERS.

When customers balk at an increase in price, you can show them where your costs have increased and why you need to raise prices. Perhaps most important, knowing (rather than guessing) whether a job will be profitable allows you to decline unprofitable jobs or negotiate more favorable terms with the customer. Or, if it's a new customer that has long-term potential, decide whether to break even or take a small loss in order to obtain a new account.



EVERY MANUFACTURER NEEDS TO OFFER COMPETITIVE PRICING IN ORDER TO COMPETE.

“When we implemented Global Shop Solutions, it was a real eye-opener to see our true costs for the first time,” says **Bill Staber, President of Staber Industries**, “mainly because we discovered they were higher than we thought. Knowing our true costs tells us how much we can come down on price in regards to competitors, and how low we can go before saying no.”

If you're constantly getting underbid by competitors or finding out that you lost money on a job *after* it shipped, Global Shop Solutions has a better way. Call us today at 800.364.5958, or [set up an appointment online](#). We'll help you get your costing—and your [shop floor](#)—under control.



ABOUT THE AUTHOR

Rhonda Gieza serves as a Team Lead and Operations/Financial Consultant for Global Shop Solutions with nearly 20 years of experience in the manufacturing industry. Gieza's dedication to her craft continues to gain the utmost respect from her peers as she instills best practices for inventory control, job costing and accounting to all of her manufacturing customers.