

European Costing Acrobatics

How springmakers deal with variable costs, market demands and pricing pressures

By Wallie Dayal



In the not-too-distant past, Europeans often cringed when Americans abruptly ended a meeting with the phrase, “time is money.” They preferred a slower, more personal pace of doing business and were quite willing to sacrifice the cost factor of time. No longer. The global marketplace demands a relentless tempo for every participant.

Springmakers who were slow in eliminating waste, automating and streamlining operations are no longer in business. Sadly, the disappearance of the family farm, the family firm and the mom-and-pop grocery store has shown springmakers the underlying trends and cost drivers of globalization. But the brave remain undaunted, they focus on finding their niche, practice flexibility and continue to thrive, as the following contributions from the United Kingdom, Denmark, Germany and Austria show.

**Bruce Clark, managing director
Central Springs & Pressings Ltd.
Redditch, Worcestershire, UK**

Central Springs & Pressings designs and manufactures diverse high-quality, specialized springs, rings, pins, washers, clips and flat metal components primarily for the aerospace, automotive, pharmaceutical and marine industries. It employs 22 people and generates \$2.1 million in revenue, supplying springs to the UK, and exporting to Africa, Central and Eastern Europe, North and South America, and India.

“We cost out every ingredient and labor step required for producing a customer’s order before we

submit our quote. This includes overhead costs, such as rising energy costs and employee benefit costs, and a small allowance for extraordinary costs to ensure that each job has a profit margin, even if an occasional batch of raw material or a faulty production batch has to be rejected,” says Bruce Clark.

Rising material costs have forced Central Springs to increase prices, and other UK springmakers appear to have done likewise. Customers did not like these additional costs, but most accepted small price increases. Some reacted with full-scale evaluations of their supplier relationships and explored potential alternative spring suppliers. In a few cases, Central Springs lost business be-

cause the customer's supplier review identified a better fit elsewhere which was not even related to unit price. The reason for the switch might have been smaller batches, proximity or the ability to transact business in local currency.

As a rule, Central Springs buys its wire or strip as needed, because storing inventory is too expensive, and purchasing the minimum quantity required for immediate produc-

tion produces the best cost/benefit relationship. Its cost-efficient shop floor operation is supported by a finely honed communication system with its customers. The system interprets a customer's order information and communicates it directly, promptly and correctly to the appropriate employee. This speeds up processing time and keeps organization and planning time at a minimum.

By assuming relatively equal raw material costs around the world, Clark stipulates that, at present, production costs in developed economies differ from those in emerging economies only by lower labor costs, taxation and the absence of environmental protection costs. But these cost advantages for springmakers are temporary. Already, Chinese labor costs are rising and pollution control, even if only in preparation of the Olympics, is beginning to claim resources. Still, emerging economies will soon attain comparable quality and productivity per man hour. Clark envisions that the People's Republic of China will evolve quality springmaking capabilities for its home markets and for some international markets in the foreseeable future. In open world markets, this will intensify competition, and springmakers will have to compete to the best of their ability. For the present, it might be best to concentrate on the silver lining of the current world market: Chinese and other emerging nations may find it difficult to generate a profit on small or medium order quantities, as they tend to concentrate on mass production. But within a few decades, this relative Western advantage may be history as well.

As participants in the global marketplace, all springmakers are subject to the same market forces. The need for efficiency is one of these forces, as is the inevitable elimination of excess capacity in its wake. This will express itself in even more consolidation and contraction of springmakers in the United Kingdom, which may present expansion opportunities for others. It is a tough market, but Central Springs scrutinizes every business opportunity carefully. It refuses work that will not generate a profit. "If we contract within a shrinking home

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market, the handwriting is on the wall: We will go broke, be acquired or have to change what we do, perhaps even buy one of our competitors," says Clark.

It is most likely that the UK spring industry will gravitate to small operations with high use of information technology and machine tools. Clark believes that only a handful of companies with more than 100 employees will be making

make springs in the UK. Most springmakers will have between 10 and 35 employees. If they use exacting costing methodologies, these companies will be profitable by supplying a customer base that is skewed away from high-volume manufacturing, such as automotive and consumer goods.

"While costing must be dealt with by every business, the greatest threat to springmaking in the UK is another matter: the lack of young people who are attracted to skilled and semi-skilled work. In general, manufacturing is associated with low pay, poor conditions, shabby pension arrangements, low status and lack of advancement; and the UK educational system is failing. It represents one of the largest barriers to the improvement of productivity and creation of wealth. Added to that is a social security system that removes any incentive for advancement. But I have personally experienced that people are willing to work very hard and conscientiously if they can improve their lot. Unfortunately, government policies have broken the link between hard work, achievement and financial reward in the UK," laments Clark.

**Henrik Hagens, owner
Hagens-Fjedre
Støvring, Denmark**

Henrik Hagens learned the spring business at his late father Peter's side, but for the last two years, the joys and burdens of proprietorship have rested squarely on his shoulders at this Danish spring company that employs 120 people.

Hagens Fjedre is close to its customers and manages its material procurement based on customer agreements. As a consequence, some customers take advantage of material price fluctuations by requesting larger purchases when prices are favorable. Others focus on their own businesses and are uninformed about raw material prices. Automatic price increases reflecting the higher cost of materials would not be accepted by the customers of this Danish springmaker. However, those customers who are aware of the market prices of

raw materials are more easily persuaded to accept a price increase.

True to traditional high Scandinavian ethical principles, Hagens-Fjedre prefers open-book agreements with customers. In such cases, customer and supplier are aware of all cost factors, and changing raw material prices should be a moot point. Ah, if it were a perfect world, costs would be pinned down once and stay put for a reasonable amount of time. Unfortunately, variations are frequent, and Hagens does not always succeed in finding the correct costing structure for every job.

The pressure on margins is relentless. Market prices drive the price of springs down, yet spring-makers must acquire costly new machinery to adapt to market demands. This poses the formidable competitive challenge of structuring costs in such a way that the capital investments pays off, especially in an environment where it is already difficult if not impossible to load spring costs with ordinary overhead costs, such as health care. "But we are in business to earn a profit, and we have had to terminate our relationships with some customers because they demanded prices that were so low, we would not have earned anything. It might even have cost us money to continue to supply springs to these customers. Still, ending long-standing relationships was very difficult," says Hagens.

Hagens-Fjedre operates in small markets with relatively local customers. This deflects the pressure of Chinese competition, and Hagens-Fjedre does not feel it as strongly as those who compete directly with Chinese springmakers. In fact, Hagens believes that many European spring customers are circumventing the quality and toxicity problems that are often associated with Chinese products by buying local. Most likely, this trend will continue.

"At the same time isn't positive that the Chinese market is growing. That means more products that require springs will be produced. This offers opportunities for growth and participation for Europe. Developments in China should not only be seen as a threat; I believe they also represent more opportunity," says Hagens.

Joachim Ahle, owner
Gebrüder Ahle GmbH & Co.
Lindlar, Germany

In 2004, Ahle celebrated its centennial. The springmaker provides 140 jobs and generates revenues of \$38 million.

Mind-boggling advances have taken place since the company was founded in a goat stable by the Ahle brothers. They saw opportunity: the new iron horse would need springs. In recent years, however, automotive customers seized opportunities to put pressure on sup-

pliers, and as a supplier to this industry, Ahle has long been under constant pressure to decrease prices. At first, the company responded with aggressive productivity improvements, but the dramatic increase in steel prices intensified the situation. "We found ourselves sandwiched between the customer and the supplier," says Joachim Ahle, grandson of one of the founders.

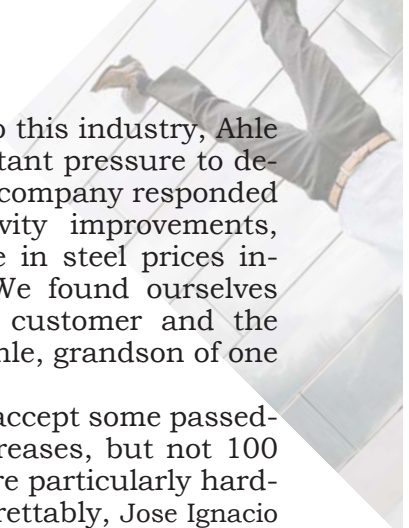
Nowadays, customers accept some passed-through material cost increases, but not 100 percent. The big players are particularly hard-nosed. Ahle says that, regrettably, Jose Ignacio Lopez de Arriortua of GM and later VW was right when he told suppliers, "You have to bleed some as well. It is not costs that determine price; it is the other way around."

Unfortunately, most cost-saving possibilities in the area of variable costs have long been exhausted. Fixed costs and others, such as energy costs, are gaining increasing significance. It is amazing that some customers pretend to be deaf when the topic of price increases is broached.

Ahle's customers want financially transparent supplier relationships. Some demand detailed information about the company's cost structure in a quotation-analysis form. But even if Ahle were willing to provide every last detail, costs would not be "transparent," unless springmaker and customer used the same costing method. That is never the case. Cost structure is unique to a springmaker, and Ahle uses marginal costing plus overhead allocations.

Before Ahle starts any price negotiation, the company carefully calculates the prices it must demand to stay in business. If a customer refuses to agree, the company has only one alternative: It must walk away; sometimes from contracts it had already been awarded. Perhaps these customers are willing to sacrifice quality and get cheaper product elsewhere or from China.

Ahle has mixed feelings about China. At present, it is not a threat to the company. On the contrary, one of its large customers has been buying Ahle springs for the last two years for its Chinese operation. But change is constant, and it is uncertain for how long Ahle will continue to send springs to China. Its customer is already working on an alternative and has set up a Chinese springmaking facility. But if it were easy to replace Ahle's springs, the Chinese orders would have stopped already. "There is no doubt in my mind that competition from China will be one of the key challenges of the future," says Ahle, "but at this point, they have not yet been able to achieve our quality."





**Dr. Heinz, owner
Gerhard Wenzl GmbH
Vienna, Austria**

Like the country of 7 million people in which it is located, the Austrian spring industry is relatively small, but Dr. Heinz' spring company is Austria's largest and he is the resident expert. He runs several operations overseeing 102 employees, who generate over \$10 million in revenue.

Trade journals, professional associations and shop talk have made customers of Austrian-made springs as aware of rising material prices as their springmakers, he says. This allows springmakers to use flexible pricing to accommodate raw material cost increases and decreases to flow-through to larger customers.

Each time a new machine is installed, the pricing structure is re-evaluated. The same process applies if other cost factors, such as energy, health care or general overhead, rise significantly. The new pricing structure is then presented to the customer in convincing, fact-based arguments in the hope of persuading him to accept the newly loaded prices. If a customer refuses to accept the new price structure, even a long-standing customer relationship has to come to its end, as a springmaking business has no future if it does not turn a profit. "We try our best to be more flexible in our pricing with our smaller customers. After all, costing is a science, while pricing is an art that is driven by strategy," says Dr. Heinz.

It is often argued that springmakers can save money by having springs produced in China. Dr. Heinz believes that to be a simplistic view, and he has been evaluating the pros and cons of Chinese production for a decade. Spring production certificates are required to accompany each delivery, as a customer will instantly know that the springs originated in China. He will therefore insist on comparably lower prices. Thus, should the carmaker have been able to obtain quality springs at a made-in-China price that is, for example, 60 percent lower, this cost advantage would not bolster the springmaker's profit margin at all. On the contrary; mandatory European open-book calculations would then reduce the permissible profit percentage.

Rather than focusing his efforts on being an exclusive supplier to the spring-intensive automotive industry, Heinz' client portfolio is well diversified and relatively large. But the added administrative burden pays off. He produces relatively small orders of 10,000 to 500,000 pieces primarily for customers in the electrical and machine-building industry. Naturally, this requires highly skilled employees,

capable of frequently switching production. But this also encourages designers to seek advice, and Dr. Heinz seeks to maintain ongoing dialogue with them.

In typical European fashion, quality is first and foremost on Heinz' mind, and it turns out to be a lucrative business proposition as well. Whether the price of a spring for a machine costing EUR 200,000 is EUR .15 or EUR 1.5 is not the decisive factor. The customer's trust in the quality of the springs, and the service relationship with its supplier influence purchasing decisions much more. These are made in the interest of protecting, in turn, the customer's own reputation with its customers.

"Fortunately, our major customers demand not only superior quality but also continual support for new products. This has put us in the fortunate position in which our physical proximity has shielded us from Chinese competition," says Heinz.

The purported Chinese advantage must also overcome local capital and know-how requirements. Even if millions of springs were produced cost-effectively in China, the implications of using them would not necessarily be positive. While Heinz concedes that springs can be made at lower costs by changing physical dimensions and type of material, for example, quality may well be affected. He would never apply a target costing method in which a spring supplier derives spring costs based on what the customer can afford and the market will bear. "That's an American thing," he muses. "In Europe, we sometimes snicker about the troubles of American space shuttles. A little more quality would go a long way."

Dr. Heinz also supplies springs for truck brakes and trains. Any failure could be disastrous. That is why every primary spring is backed up by a reserve spring that picks up 90 percent of the spring load, should a failure ever occur. To date, that has never happened. Dr. Heinz is proud of the millions of springs he has supplied without receiving any complaints.

"In the end, costing is just a part of business strategy, and we apply old-fashioned fully loaded costing. In today's environment, business conditions are similar for all springmakers, but each has to find the strategy that suits his operation," says Heinz.

Time will test each springmaker's success strategy and sustainability. One thing is certain: The global economy, as well as its Oriental growth engines, depends on springs. And the gap between quality and low-cost mass production spells opportunity for those who have the vision, resolve, energy

and flexibility, anchored in the fundamentals of a sound cost structure suitable to their specialty.

Wallie Dayal is president of Dayal Resources Inc., a Chicago-based firm that helps initiate and support American-European business. Readers may contact Dayal by Web site at www.dayalresources.com ❖

