



How to maximize profitability in SME organizations?

Most of the SME organizations can be classified as either Tier 2 or Tier 3 level vendors to OEM. Those organizations are adding value to the final product either by way of partial manufacturing or manual content addition in the material. That is mostly the scope of the SME's restricted to manufacturing or assembly and may not have much leverage on design, procurement aspects on the value chain. In some organizations, value addition is limited only to the manual work.

Unlike large size organizations, SME's does not have the bandwidth to design and development of the product, RM selection and procurement, process planning and manufacturing, Assembly and Testing on its own. If the scope of SME's on revenue is relatively smaller than large size organization, how can SME's maximize the profitability?

Given below some of the proven methods from our experience with SME's and the critical aspects of each method.

1. Increasing the volume

2. Increasing the variety and customer's base

3. Cost optimization from P&L analysis

4. Rationalizing the product mix or portfolio

5. Vertical integration

6. Looking for premium products or market

7. Looking for premium processes

1.Increasing volume:

One of the typical methods of increasing profitability is doing more volume as it covers up the overheads and there is a possibility of maximizing profitability. The prerequisite for increasing volume of a given customer's product is the price and quality expectations to be met consistently. Most of the organizations are working internally on quality improvements, delivery plan adherence, and price optimization so that they can approach the customer for 100 % share of the business. Since the demand is a function of external parameters, there is a limited scope to increase the volume beyond a certain level.

2.Increasing the variety and customer's base:

One of the favorite ways of increasing the sales turnover, in turn, profitability is by expanding customer's base and get more orders of the similar product family. For example, if SME's has modern machining facilities, it looks for different customers and product range to maximize the revenue and profitability.

The advantage is that it helps the organization not to get into the risk of dependence on one customer and also helps the organizations to serve the different product varieties and customers to get more visibility in the market. The downside of this approach, over a period, managing multiple customers with multiple varieties leads to operational inefficiency issues. Most of the organizations

fail to plan well and ended with operational issues like more changeovers, higher cycle time, higher WIP's, quality issues, lack of focus on time deliveries low productivity. However, for some organizations with better operational team and practices, this method turns out to be a better method of maximizing the profits

3. Cost Optimization from P&L Analysis:

This is an all-time workable solution, proof from recession or unfavorable external environments. Irrespective of existing customer's base, volume, product mix and variety, some SME organizations are continuously working on waste elimination, re-engineering the process and identification of opportunities to save the cost of P&L analysis. For example, one of my known organization regularly saves 3-5 % in its conversion cost every year irrespective of volume or external condition only through continuous improvement programmes and finding opportunities to cut down the unnecessary expenses.

Another advantage of this methods, the organization develops the culture of cost consciousness as a way of life.

4. Rationalizing the product mix or portfolio:

This method is mostly last options or impossible options by SME organization as they are vendors to OEM customers and they can not influence on changing the product mix or portfolio. However, wherever the organization supplies directly to end customers influence to choose the right product mix as it maximizes the profitability significantly.

It requires active accounting and cost deployment practices, wherein the organization can precisely know the cost of goods sold for each product

mix. Accordingly, the management decides the product mix be continued or dropped.

In one of my client, when we did products costing and selling price analysis, we came to know the some of the product ranges, the organization is making losses as the cost of manufacturing outweigh the selling price. The management took timely decision to drop some of the low-end products, thereby could able to release the capacity for the higher end as well as to increase the profitability.

5. Vertical integration:

One of the common practice prevailing in most of the SME's over a period, after stabilizing the basic process and get the customer's confidence, they get into vertical integration as a natural growth. This expansion gives growth and profitability advantages to the organization.

For example, an organization specialized in forging or casting is expanding the horizon to machining and assembly.

This method is workable once the organization establish themselves with the basic process and have a financial and technical bandwidth to expand vertically. However, this method requires continuous reevaluation of product cost and sales realization.

6. Looking for the premium product or new market:

One of the possible option for SME organization to look for premium product lines or new market whereby it enjoys the premium. It calls for expanding the marketing effort to find to find the niche or premium product lines and customers.

7.Looking for the special process:

Rare and ultimate option for SME organization to get into the special process to enjoy the premium as this must be the entry barrier to others.

In today's competition and free market environment, the organization can be healthy only by generating sufficient cash reserve through profitability.It is the business head or CEO's prime responsibility to revisit the model continuously.