Relocating/Consolidating Facilities – Caution Ahead
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The relocation or consolidation of manufacturing usually stems from a company's desire to support the growth of the business, reduce operating costs, attract management, or for other strategic reasons. However, many companies underestimate the significant financial and operational risks associated with such an undertaking, whether it consists of a move across town, to another city, or overseas. This article will examine some of the risks involved and provide recommendations to minimize those risks.

Motivating Factors

The decision to move all or part of a company's operations is usually initiated by an anticipated material growth or reduction in revenues and/or anticipated manufacturing and operating improvements. Based on our experience, the following are several of the more common reasons for facility relocation:

- Inadequate facility size to capitalize on growth opportunities;
- Downsizing of operations;
- Lower labor/manufacturing costs;
- Proximity to distribution channels;
- Opportunity for government incentives.

Risk Factors

Relocations present certain inherent challenges that must be understood as part of the decision making process:

Loss of personnel – most companies consider retention issues for senior management, however they underestimate the impact of losing both mid-management employees, who have intimate knowledge of critical operating issues, and the loss of a skilled workforce (where the rate of retention is usually lower). Key-customer and vender relationships may be impaired due to the loss of these employees. In addition, new employees are invariably subject to a significant learning curve, and the company often experiences a higher rate of turnover in the period following a move;

Information Technology issues – the IT function is an integral part of any operation and is critical to ensure a seamless transition of the operations to a new location. Significant time and budget is required to ensure systems can be successfully transitioned and restarted in the new location. Failure to address critical IT issues prior to relocation can paralyze operations, from receiving and production to shipping and billing;

Moving and installing equipment – this is often one of the most logistically challenging elements of a relocation. Problems we have observed include:

- **Improper set-up or damages** in transit, resulting in significant initial downtime and/or production quality problems in the new premises;
- **A poor new plant layout** can lead to inefficiencies and an initial decline in productivity. Adapting to a new layout may be particularly challenging if the company does not retain experienced production managers at its new location;
- **The infrastructure** in the new plant may be inadequate to support the manufacturing equipment. For example, the electricity supply, sewage system, and waste disposal may be insufficient and may require a substantial investment to upgrade.

Difficulties in inventory management – similar to moving and installing equipment, relocating and organizing inventory into a new warehouse can pose significant challenges. An inadequate system to track the movement of inventory can result in higher costs, lower fill rates, and loss of product.

Operational and Financial Consequences

Failure to address the operational risks associated with relocation can result in significant consequences to a company's operations and ultimately to its financial situation. This can be seen in the following areas:

Productivity decline – the loss of experienced personnel, morale issues, equipment downtime, and/or IT issues can contribute to a significant decline in productivity and output at the new location. Production inefficiencies often lead to a drop in customer fill rates, lost sales and customer dissatisfaction. This often results in increased overtime and temporary labor costs and expensive expedited shipping alternatives to compensate for production delays;

Product quality issues – inexperienced employees and set-up problems with new or relocated equipment can lead to a temporary decline in product quality;

Lack of continuity in key support functions – turnover of key support personnel can result in delays in billings and collections (resulting in a strain on working capital requirements) and an inability to produce information on a timely basis (perhaps delaying the identification of problems);

Damaged customer relationships – failure to deliver, late deliveries, large order backlogs, increased returns, and the lack of continuity from lost salespeople may strain relationships with customers and may bring about the permanent loss of key customers. Companies with customer concentration issues are at risk of a significant downturn in sales as a result of a poorly executed relocation.

Strategies to minimize risks

A detailed comprehensive relocation plan must be developed, coordinated, managed, and implemented properly in order to minimize the potential risks. The following should be considered:

Planning – a dedicated team from throughout the company (including senior management) must be assigned to control all aspects of the move. Companies should consider hiring a professional consultant to advise on and, if necessary, manage the overall process. This is not a process that can be performed on a part-time basis;

Timing – timelines and schedules must be set up and monitored for the completion of all tasks, some of which are co-dependent on each other. In addition, there may be long lead times for essential equipment and services required. Furthermore, the company must consider when the move should take place during the year, as it can be more difficult during the company's busy season;

Communication – the relocation must be communicated appropriately to employees, suppliers and customers whose cooperation is critical:

- **Management must communicate** with employees to minimize uncertainty and rumors, which affect morale and employee retention. Employees will be more satisfied if they are involved in the process and their concerns are being dealt with. In addition, management must speak to personnel at all levels to understand what the expected loss of personnel will be. The move may not be feasible if key employees refuse to relocate;
- **Suppliers must be notified** to coordinate the deliveries of raw materials during the period of the move. This is especially important if inventory is built-up in anticipation of the move to ensure materials are available for additional production or sale;
- **Communication with customers** is essential so that they are aware of the upcoming strain on resources. It may be possible to accelerate payments from them or arrange for shipments ahead of delivery dates scheduled during the time of the move. They may be accommodating if they are well informed.

Inventory build up – building up inventory prior to the move allows the company to avoid lost sales and missed delivery dates should production delays arise. Companies should assess whether this is feasible considering existing capacity constraints and available working capital;

Parallel operations – due to the potential problems that may be encountered at the new location, companies should consider running parallel for a period of time, if possible, until the new location is properly structured. This could minimize the effect of problems and delays at the new location as relocation issues are resolved;

Budgeted costs – the relocation budget should consider the impact of lost productivity, higher operating costs, and a potential slow-down in shipping, billing and collections. In addition, it must be based on realistic costs for employee relocation, recruitment, travel, training, consulting fees, and other expenses as required. Many unbudgeted costs may emerge as the move progresses if not adequately managed.

Other items to consider include:

- **The impact** of the relocation on purchasing and production schedules. Relocation usually affects procurement times for raw materials from suppliers and goods shipped to customers;
- **Consideration of the impact** on cost of goods sold components and potential changes to standard costs.

Conclusion

There are serious risks associated with corporate relocation that can significantly impact operations and financial results. Unforeseen costs, loss of key personnel, damaged relationships with customers, suppliers, and employees, and other problems can lead to adverse consequences for a company. Many companies are weakened considerably, temporarily or permanently, as a result of an ill-planned relocation.

As a result of the potential significant erosion in working capital that can occur during a relocation, lenders may suddenly discover that their security has decreased, additional borrowings are required, and covenants are not being met. We recommend that lenders obtain key details of a customer's relocation plans well in advance of the target date, and obtain regular progress reports throughout the relocation.

Richter Consulting, Inc. has a comprehensive financial advisory practice in the areas of business reorganization, insolvency consulting and transaction advisory. If you have any business reorganization issues, including questions regarding this article, please contact the authors, Howard Gross and Morrie Rutman.

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