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Management Topics

An Updated Look at Occupational Fraud

Every two years, the Association of Certified Fraud Examiners (ACFE) produces its Report to the Nations, a study of the impact of occupational fraud. This type of fraud, which employees commit against their employers, is among the costliest forms of financial crime, causing billions in losses annually.

Sadly, the manufacturing industry experiences significant damage from occupational fraud, reporting the third most cases in this year's study, behind banking and financial services and government and public administration. Median loss in manufacturing was $198,000, almost double the median loss of all industries.

The Perpetrators

A perpetrator's level of authority typically matches the size of the fraud—the higher up in the organization, the greater the loss. For example, while owners and executives committed only 20 percent of frauds, the median loss in those cases was $600,000. The same is true of the perpetrator's tenure with the company—longer employment equals greater loss—and the duration of the fraud, with more authority resulting in longer duration.

More than 70 percent of perpetrators are male, and more than half are ages 31 to 45. Slightly fewer than half have a college degree.

The departments that pose the greatest risk are operations, accounting, and executive and upper management, with sales and customer service rounding out the top five.

The Schemes

There are three major categories of occupational fraud: corruption, asset misappropriation, and financial statement fraud.

Corruption includes schemes such as bribery, extortion, and conflicts of interest. Asset misappropriation includes cash and inventory theft, billing and payroll schemes, check and payment tampering, and skimming. Financial statement fraud includes net worth and net income overstatements and understatements, along with the various tactics that result in these misstatements, such as improper asset valuations and fictitious revenues.

Manufacturers suffer most from corruption schemes, followed by billing, noncash, and expense reimbursement crimes.

Detection Methods

How are most frauds detected? Tips. Forty-three percent of occupational frauds in the study were detected by tips, followed by internal audits and management reviews. Almost 75 percent of the tips came from a combination of employees and customers.

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Word to the Wise

Do's and Don'ts: Pricing in a Pandemic

For manufacturers, there's never been a time when demand and pricing seemed so difficult to manage. Some sectors have experienced sharp drops in demand, while others can't keep up. Heightened price sensitivity means more customers are asking for discounts or extended terms.

Demand Drives Pricing

Companies generally fall into three categories regarding demand, which in turn drives their pricing decisions.

Demand down: Manufacturers—and their suppliers—in many sectors have experienced drastically reduced demand. For example, demand for textiles, furniture, and apparel has waned. Customers are no longer willing to pay what they were paying, discounts have increased, and for many companies, survival is the main goal. Pricing adjustments in this arena may be futile as a long-term strategy because the lack of demand is currently so acute.

Demand up: Some companies have experienced explosive demand, such as manufacturers of cleaning supplies and paper products. As demand has gone up, keeping supply available has been a challenge. Prices have certainly increased, and most manufacturers have handled these price increases respectably. But the few who took advantage of a global emergency have experienced significant blow-back and even legal trouble.

Demand is moderately affected: Some companies have continued on course. Some have been affected negatively by a general slowdown in spending, but positively as needs have shifted and working from home has become a norm. Examples here include consumer electronics and use-at-home tools. Pricing in these areas has flexed with their demand.

Getting It Right

McKinsey & Company offers some ideas for "do's" in terms of pricing considerations during the pandemic. Among them:

Strengthen messaging. Your sales team must be able to communicate your value. If your sales force needs new messaging training, now is the perfect time. Focus on building listening and negotiating skills, both of which can be used effectively in person and via video calls.

Reinforce trust. If you are able, meet customers where they are and give them what they need. This might include customizing offerings, revisiting contracts, and determining what is most important to them. Consider loyalty incentives to keep customers close.

Stay flexible. According to McKinsey, "The outperformers in today's environment will address customers' short-term pain points without needlessly destroying long-term value." This might include temporary pricing or volume adjustments.

Rather than locked-in, long-term adjustments, stay flexible so you can maintain profits when the recovery rolls around. For example, consider one-time promotions, flexible payment terms, or credit for future purchases. These tactics will preserve long-term value but will also assist customers if they are struggling.

Ask your team. A cross-functional internal team can offer unexpected insights into pandemic pricing solutions. They can examine contract terms, service charges, or other details that often get lost as customer relationships age.

Look Sharp

Of course, there are "don'ts" as well. For example, manufacturers must stay current. Everything from regulations to consumer confidence is changing rapidly. Customers might have specific pricing sensitivity—and that might change, too. Conducting a customer survey can illuminate interesting data points.

Also, it's wise to act quickly but not impulsively. Slashing prices might be helpful in the short run but may destroy value long term. Keep an eye on competitors and how they're responding. Determine where you want to land relative to their actions—or inaction.

Pricing can be challenging in the best of times, so be careful tackling this tough topic during a once-in-a-century pandemic.

Our team can help you think through your pricing decisions. Contact us to set up a time to talk.

Source: McKinsey & Company

Transition Planning

Should You Stay or Should You Go?

Baby boomer owners have lived through a number of disasters, including the dot.com bust, the Great Recession, and now a pandemic.

Reaction to this latest crisis has ranged from retrenching, "I'm going to work forever!," to running away, "I've got to get out of here as soon as possible!" So, as an owner, will you stay or will you go? Is now the time or is it prudent to wait?

Define Goals

The timing of your exit will be determined by a number of factors, including your personal and business goals.

Personal goals: In terms of personal goals, perhaps the pandemic has inspired fondness for working remotely or working less. Conversely, you may miss working at full speed in the office, and getting back to your plant has never been more appealing.

Maybe you're motivated to find an entirely new career given the global upheaval. Or it may be that you're eager to learn more about a topic and an advanced degree is in your future.

Business goals: Eventually, you will transition leadership and ownership. How do you want to do it?

For example, some owners are determined to leave a legacy for the community and employees, so a management group buyout is the goal.

Others want to bring in new investors who can provide an influx of cash and take the company to new heights. Still others have their own big vision for the future and are ready to change things up and pivot the company in a new direction.

All of these personal and business goals are acceptable, but defining them is key. Once you know where you want to go, there are many roads to get there.

Define Strengths and Weaknesses

Defining your business's strengths and weaknesses is an essential next step. The questions are relatively straightforward: What do we want to accomplish? What resources do we have? What strengths can help us toward our goal? What weaknesses will impede our progress?

For example, your business may have an A+ customer base you'll want to protect for the future. Or maybe you create unique products, and that's a competitive edge you will want to maintain. Or perhaps your financial position is particularly rich, and it will allow you to take some lucrative risks.

Naming your company's strengths, weaknesses, opportunities, and threats using a SWOT analysis is an effective way to identify resources and highlight gaps. The results will be revealing.

Define a Path

Now you need an action plan. Given your options, what step will you take to reach your desired goals? What will it cost? How long will it take? What's realistic?

Most transitions go better when there's plenty of time to accomplish goals. Your trusted financial advisors will tell you that it's never too early to start thinking about what's next for you.

Give yourself at least two years, if not five to 10 years, to build value and exit as you desire. And count on your CPA and other advisors to help you get there.

Be Prepared Against Fraud

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Telephone hotlines were the most common reporting mechanism, very closely followed by email and online forms. In about a third of the cases, whistleblowers reported their suspicions to their supervisors rather than using a formal reporting mechanism.

Anti-Fraud Controls

A robust anti-fraud program includes a suite of controls. The top three include a hotline, an anti-fraud policy, and fraud training for employees, managers, and executives. But all anti-fraud controls are not created equal.

For example, having a code of conduct in place seems to reduce fraud by a little over half. The presence of an internal audit department, management certification of financial statements, external audits of internal controls, and management review reduce fraud by 50 percent. Surprisingly, rewards for whistleblowers only lower fraud by about 2 percent.

Protect Your Assets

Occupational fraud causes an alarming amount of financial loss for manufacturers. Fraudsters are aware that the COVID-19 crisis has shifted focus for many owners. Don't let them steal what you have worked so hard to build.

We care about protecting your business from fraud. Let's discuss next steps.

How Is Your Technology Helping You?

Very early in the pandemic, the National Association of Manufacturers conducted a member survey asking about the impact of the coronavirus outbreak on their businesses.

At that point, more than 78 percent reported that the uncertainty around the COVID-19 outbreak was likely to have a negative financial impact on their businesses. More than 53 percent anticipated a change in operations in the coming months.

All indications suggest that, in most cases, these respondents were correct in their predictions.

A few months later, Industry Week conducted a survey, also asking about manufacturing operations during the COVID-19 crisis but focused on whether digitization and other "Industry 4.0" technologies have played a role in manufacturers' ability to remain agile during the pandemic.

[If you are not familiar with the term, Industry 4.0 or Manufacturing 4.0 represents the fourth revolution in manufacturing. It is the next wave—one that optimizes computerization and involves connectivity and communication, allowing decisions to be made without human involvement. The Internet of Things (IoT), robotics, and autonomous vehicles are examples of Industry 4.0 technology that many companies have already implemented.]

Not surprisingly, the answer is yes. Forty-five percent indicated that Industry 4.0 technologies have given their companies the ability to track operations and efficiency to maximize output and maintain quality during the crisis.

Among the technologies considered to be particularly beneficial are wireless connectivity; the cloud; cybersecurity; environmental, health, and safety controls; automation and robotics; and video and LiDAR technologies for worker safety and health.

In fact, many manufacturers have learned that their Industry 4.0 technology investments are "must haves." As the Industry Week survey concluded, "While manufacturers may be tempted to slow or halt IoT investments during uncertain times, it's clear that organizations that continue to make Manufacturing 4.0 a priority will have a significant advantage moving forward."