By Ivan Uttley

Every Small, Medium and especially the larger businesses with whom I have conducted the following exercise, which is almost trivial in its formulation, has been taken aback at the insight provided.

Failure is the opportunity to begin again, more intelligently

"How do we make money?"

Such a simple question, such an important question, one you'd expect every employee to have asked, let alone the senior leadership team.

So, right now, whether you are responsible for Sales, Marketing, or even IT or HR, answer these questions:

1) For last year and current Year to Date, which of your Customers are most valuable to your business, and which ones the least? Just name the top 5.

2) Which of your products or services generates the most value and which the least.

3) What is the most important customer facing channel in your business?

4) Where in your business are your 3 biggest value destroyers?

Too simple, not the right question?

Would you agree that for such fundamental questions, you'd hope for and expect complete alignment within the leadership team, and a fair amount across the rest of the business?

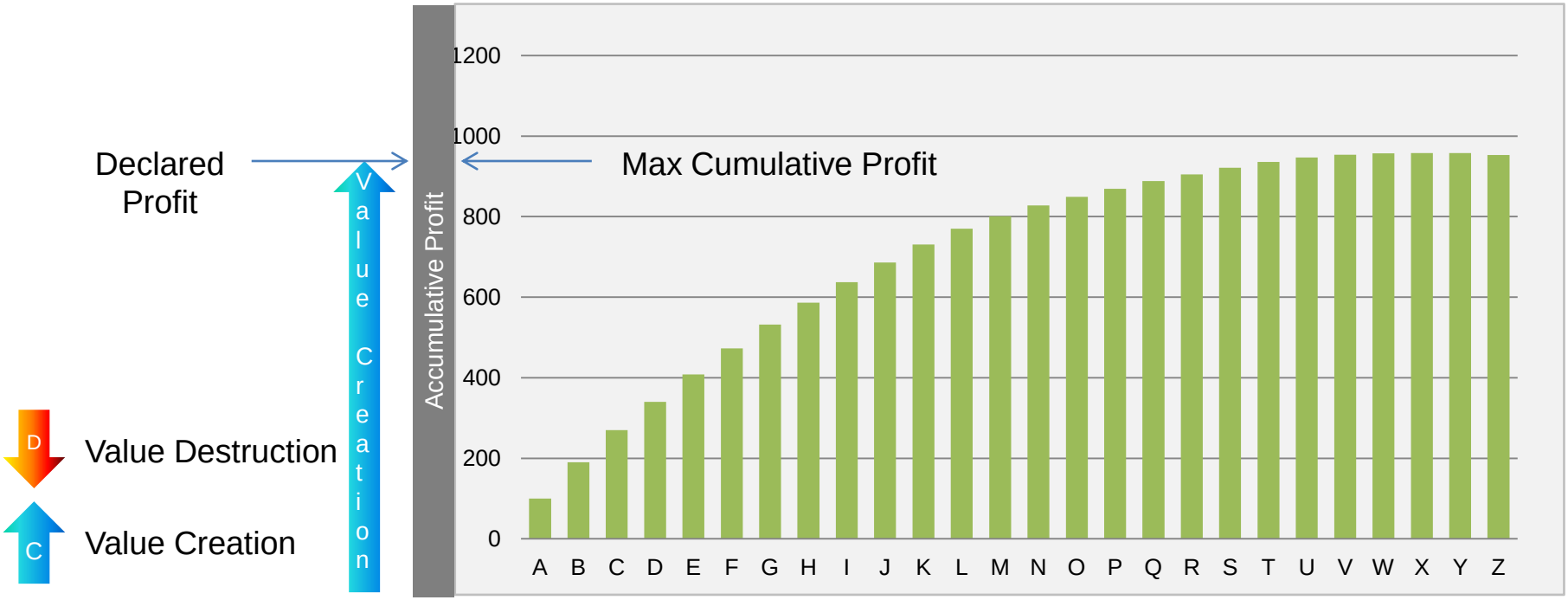
Not once have I ever had a consistent answer, even when dealing with firms like eBay or Barclays!

Business' always have a distorted view of who their valuable customer actually are

And where value is created in their business, but most importantly where value is quietly and consistently allowed to be destroyed.

The best audited outcome for this approach I have had personally was a >20% impact to bottom line within 12 months.

Plot any profit driver vs. cumulative profit? You expect?



Clients ranked by the Value they contribute

Observations

If this is true, then we need you running the country, not your company! However, I suspect

a) You have not differentiated between fixed and variable (transaction & service) costs and just allocated them evenly
b) You have not accounted for discounting either
c) You are mixing up Sales Volume with Value
d) You don't have the data at this granular level
e) You are unclear about your business being scalable and you are not ready to grow!

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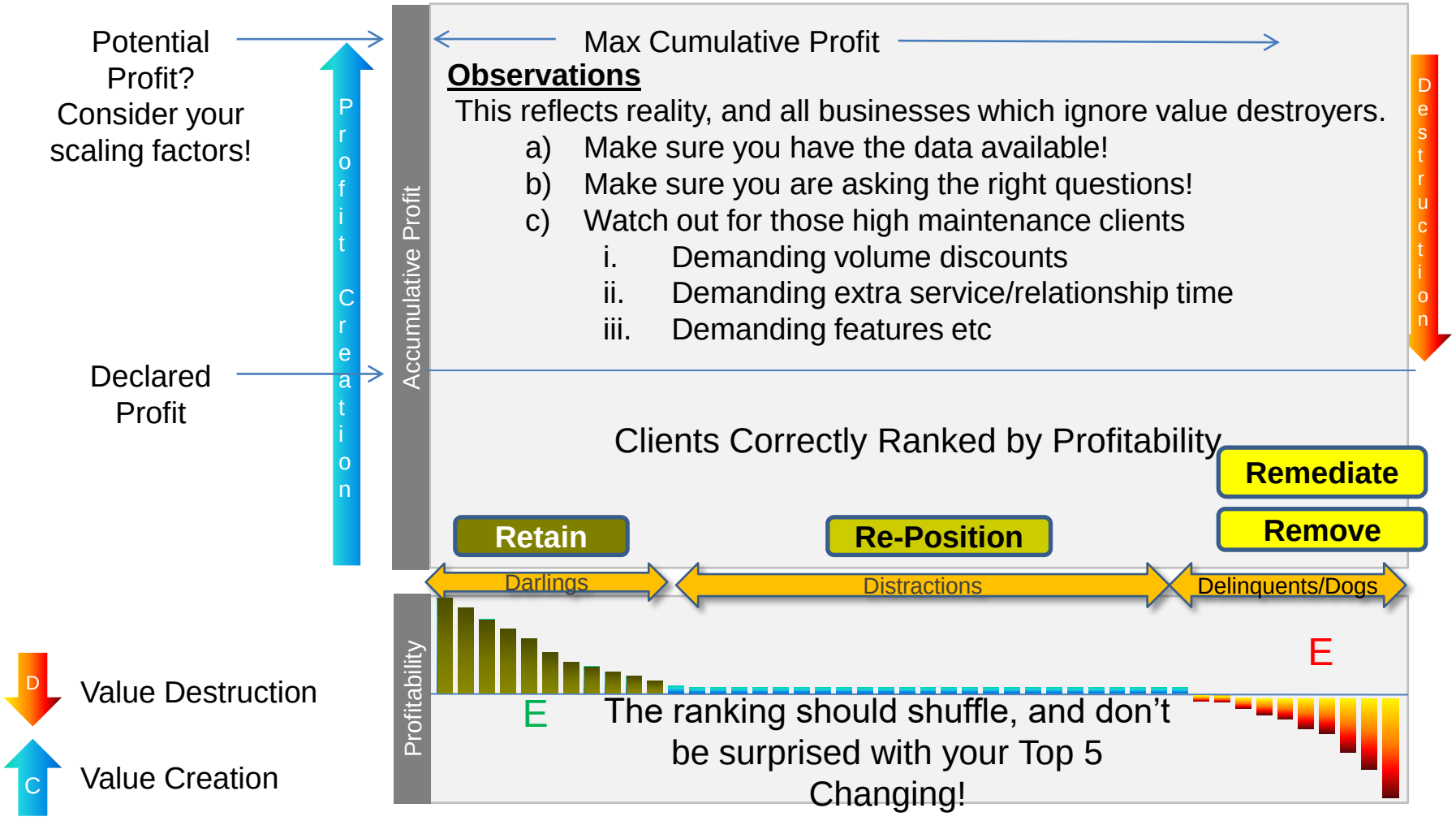
After attending to the observations made, we expect reality?



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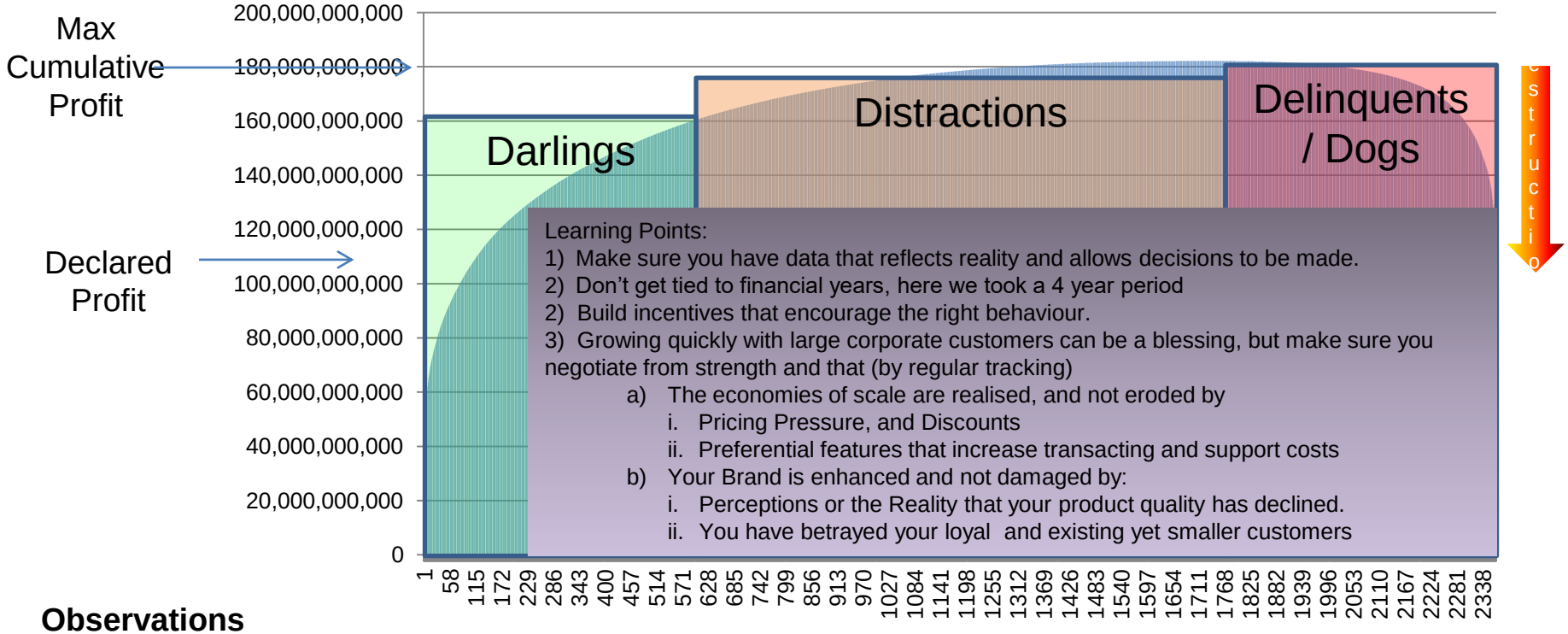
Here is a real example!



Observations

This is a great example of an business, which had great scaling properties, but grew with poor discipline, had sales incentivised on revenue growth alone, via a generous commission, and which pandered to large institutions.

a) Max Accumulated Profit occurred at 180.2 Million from 1728 Value Creating Customers
b) Reported Profit was 100.4 Million. After 79 Million of value destroyed or over 40%
c) Of the 610 Delinquents, the worst 10 accounted for 30 Million of the losses!
d) The two largest value destroyers were ranked 7th and 5th in terms of Revenue Sales!
e) Hubris allows distractions

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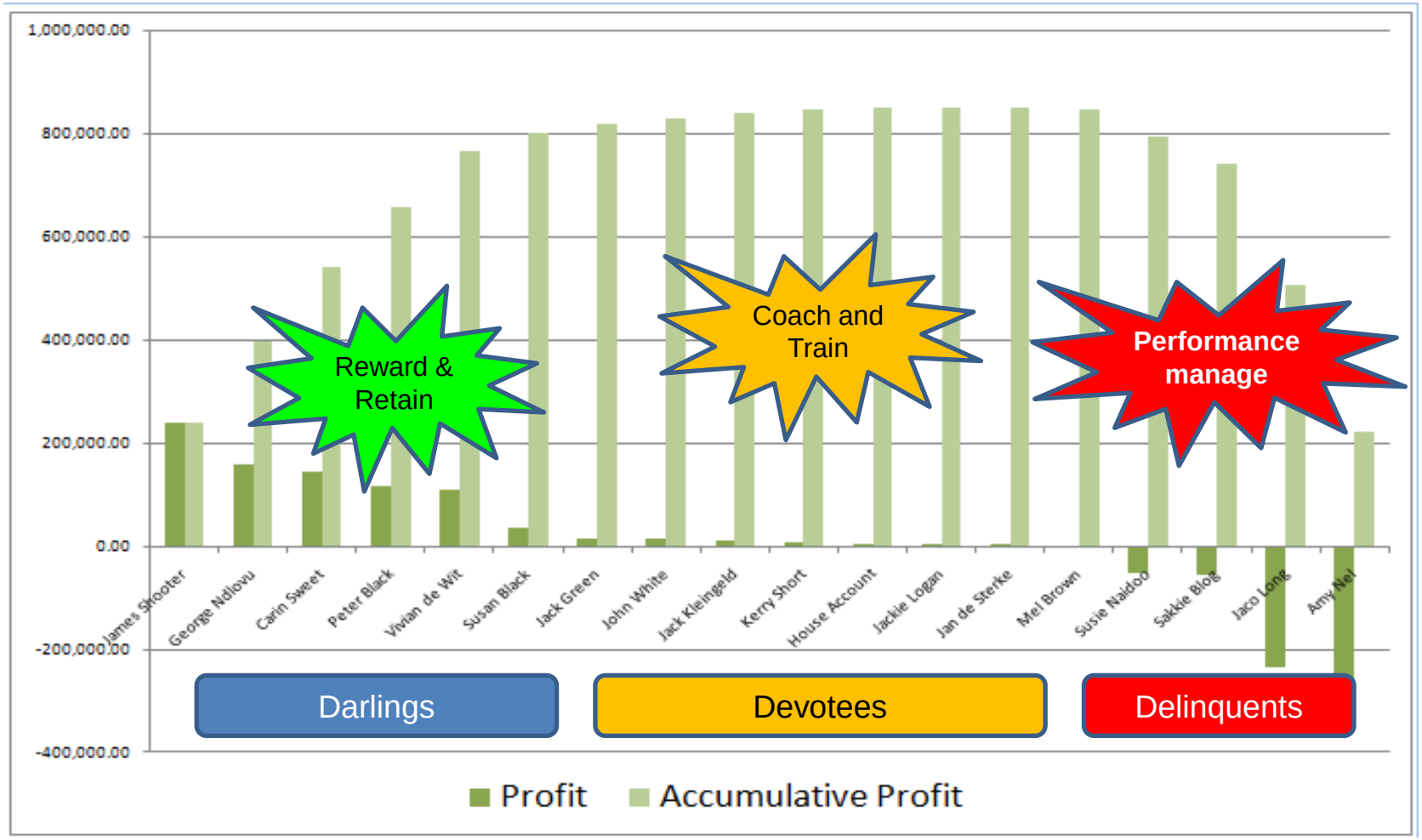
Understanding who in your front line delivers value



Apply the same methodology across, product, branch and service, customer segment etc

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Apply the same technique to the other Value Drivers!

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Investigate then include these in your management reports and tracking

- You should generate this for all your obvious Value Drivers. (and ones you don't know)
  a) Sales Region
  b) Sales Portfolio
  c) Sales Executive
  d) Service Channel
  e) Product
  f) Customer Only - Value Contribution by Lowest resolution
  g) Customer Segment – such as Life Stage or LSM FSM

- Try Value Drivers you don't know but suspect
  i. Net Promoter Score
  ii. Complaint Segment
  iii. Product uptake
  iv. Retention segment

- The value tranches you observe, should always have measurable actions applied to them. Sales for example, now could have these measures to start.
  I. Retention in the High Value tranche
  II. Acquisition of New Customers into the High Value Tranche
  III. Remediation of Delinquents/Destroyers – (removal must also have the associated fixed costs removed with the loss of Revenue – be careful!!)
  IV. Repositioning of the Potential/Marginal Value tranche

Have your answers remained the same?

1) For last year and current Year to Date, which of your Customers are most valuable to your business, and which ones the least? Just name the top 5.

2) Which of your products or services generates the most value and which the least.

3) What is the most important customer facing channel in your business?

4) Where in your business are your 3 biggest value destroyers?

5) Is there alignment and common commitment to removal of your biggest value destroyer for the next quarter?

So what will we achieve

This tactic allows you to

1. Have a bottom line impact which is far greater than looking at value creation
2. Adopt a tactic that does not require funding, where as revenue generation often does
3. Have a more immediate impact on your bottom line
4. Spend less effort for a better result
5. Alert some parts of the business that despite their best efforts they are destroying value
6. Is a far more certain result than revenue projections because this deals with reality!

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Appendixes & Supporting Documentation

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Self-funding tactics – Cash Conversion – Example B

We agree that it takes money to make money. A business, even one with a tight, scalable business model will consume more cash in its growth phase, than in its steady state. So this is a vital question for any growing business and often the reason why businesses run into trouble – their success is their undoing – tragic!

There are two questions that require answers especially for growing and constrained businesses:

1. For what period of time is your company's money tied up in inventory and other current assets before customers pay for the end product or services?

2. What amount of cash is needed to finance each unit of sales and what is the amount of cash generated by each ZAR 1 of sales?

9 out of 10 business have no idea of what the answer is.

Source http://www.spark-sme-services.co.za/method/Cash/Mob-CashSFGCalcExample.html

SFG - Self Financing Growth Rate- the rate at which growth can be sustained by cash generated by the business itself without any external source of funding

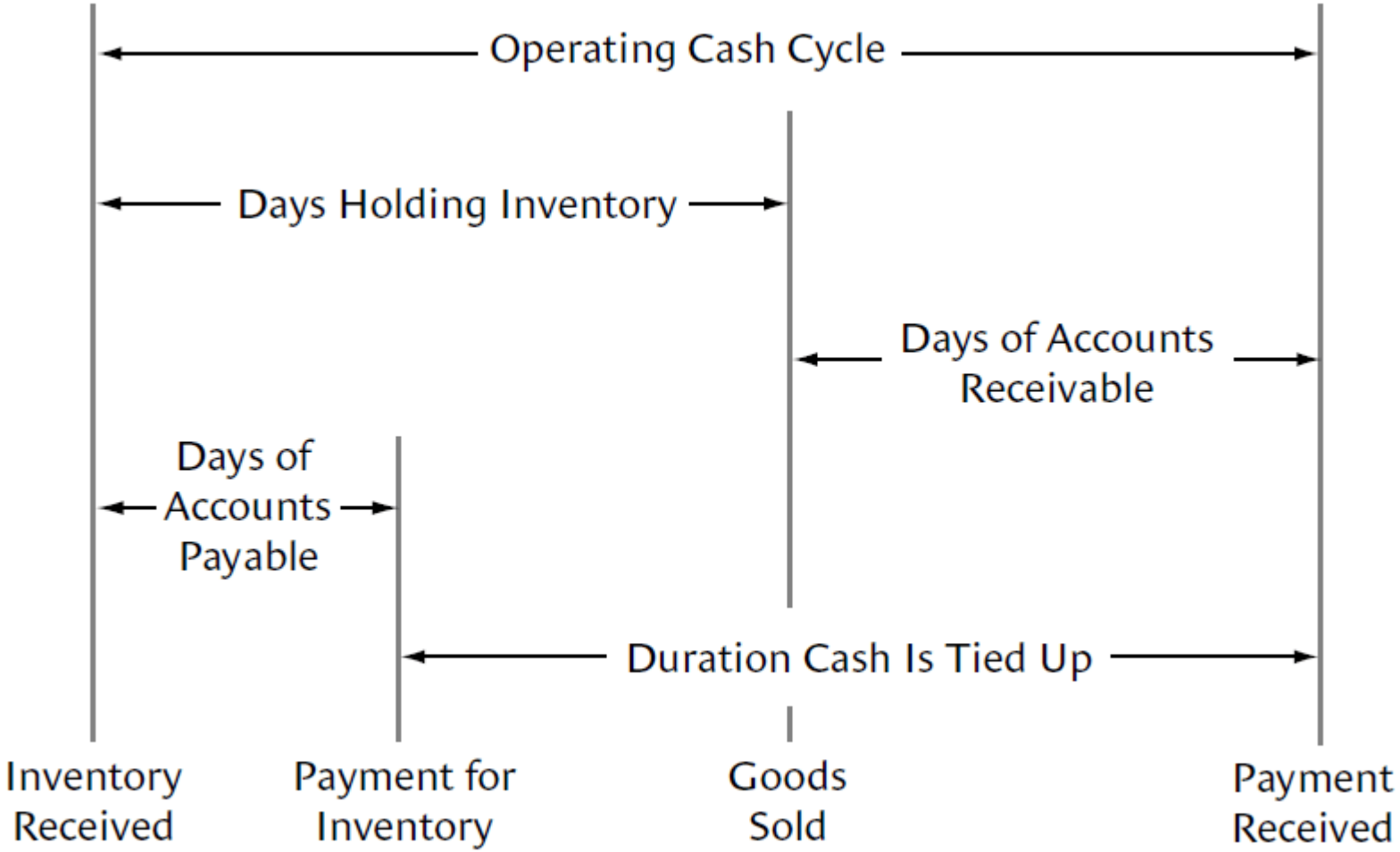
OCC - Operating Cash Cycle - the period of time between starting assembly of all the required inputs into the production line, and when the cash is handed over back to the business as payment for the sale. The sale ie the customer has the actual product or uses the service well before the business receives payment. This difference is referred to ***Accounts Receivable Days***. Like wise the time at which your production starts, having received inventory, and the moment your business pays for this inventory is the ***Accounts Payable Days***

CCC - Cash Conversion Cycle - the period of time that working capital is tied up. The time between when it was converted from legal tender into one of the inputs for the production line, and when the product converted it back to tangible cash handed to you when customers paid you in real money! or the difference in time between OCC - Operating Cash Cycle and Account Receivable Days

You will observe that different products have different inputs, different production times, and even different terms of payment for large customers. These variations need to be kept to as few as possible

Source http://www.spark-sme-services.co.za/method/Cash/Mob-CashSFGCalcExample.html

Self-funding tactics– CCC – How Cash gets tied up



Our unit of measure to start off with is Days – but we are dealing with Cash – a problem?

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Source http://www.spark-sme-services.co.za/method/Cash/Mob-CashSFGCalcExample.html

Self-funding tactics – CCC – Where is the Cash tied up?

From our previous slide, our timing diagram, the inputs are clearer, these being:

1. firstly the period of time we have to pay our suppliers

2. secondly how much time we grant customers to pay us

3. thirdly, how much time we use in turning inventory into product that is sold, which is made up of production, distribution and selling components, this level of detail is sometime not initially available to you but can be aggregated in Holding Inventory Days.

Self-funding tactics – We turn to our Audited Financial Statements

We have a Balance Sheet for the year from which we can get:

Assets	ZAR amount in (000)	Equivalent Days	Liabilities	ZAR amount in (000)	Equivalent Days
Cash	10		Accounts Payable	99	Calc A
Accounts Rec	384	Calc B	Loan Repayments	50	
Inventory	263	Calc C	Current Liabilities	149	
Current Assets	657		Retained Earnings	183	
Plant & Equip	25		Capital Contributed	350	
Total Assets	682		Total Liabilities	682	

and we have an Income Statement for the year, from which we can get

	ZAR amount in (000)	Day Equivalent in (000)	Ratios in %
Revenue/Income	2,000	=2,000 / 365 = 5.479	100
Cost of Sales	1,200	=1,200 / 365 = 3.288	60
Profit	800		40
Operating Expenses	700	= 700 / 365 = 1.918	35
NPBT - Nett Profit Before Tax	100		5

Thus the business generates ZAR 5479 of income per day at a cost of ZAR 3288 per day.

Source http://www.spark-sme-services.co.za/method/Cash/Mob-CashSFGCalcExample.html

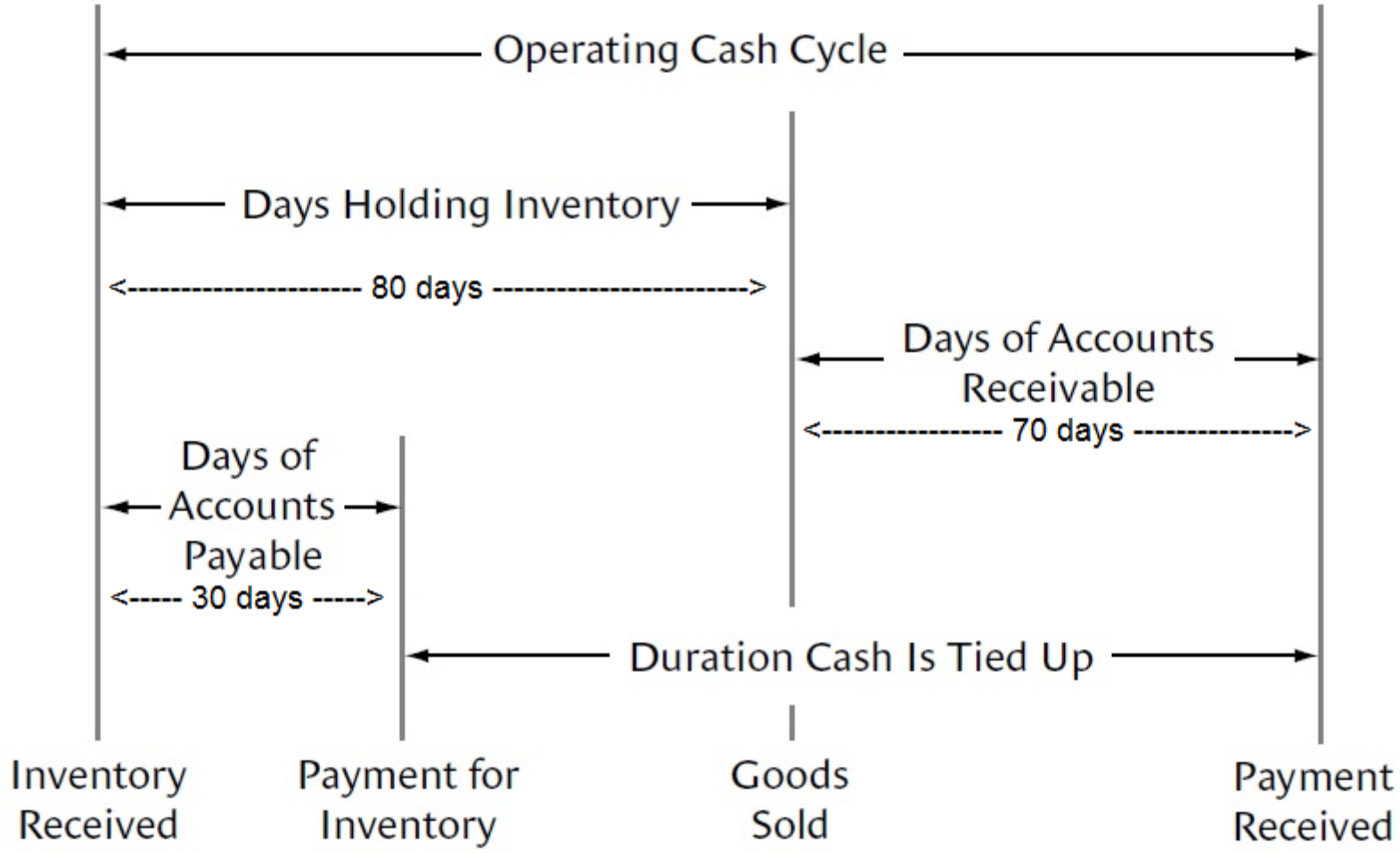
Notice that you do not need to conduct a process tracking exercise to understand your operating cash cycle. You look at the data in your Balance sheet and Income statement.

In this example the business generates ZAR 5479 of income per day at a cost of ZAR 3288 per day.

- Calc A - we owe a total of ZAR 99k to our suppliers, which at 3288 per day comes to~ 30 days (99000/3288)
- Calc B - we are owed ZAR 384k from our customers, which at ZAR 5479 per day comes to ~70 days (384000/5479).
- Likewise for Calc C, the amount of inventory we have paid for and need to turn into a sold product in equivalent days is ~ 80 days (263000/3288)

We now have our Days equivalent and for clarity go back to our timing diagram

Self-funding tactics – Our updated Timing Diagram



Service& Manufacturing Companies will differ but not as much as you think.

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Source http://www.spark-sme-services.co.za/method/Cash/Mob-CashSFGCalcExample.html

We still need to account for the OpEx - Salaries, Utilities, Rent, Marketing Costs, we can safely assume (but check this for your business) that bills arrive uniformly over the 150 day OCC period, meaning some will be paid immediately (Day 150) or have to wait (Day 1), on average this is 75 days. So now we know for **how long** the cash is tied up, now we just have to see **how much** is tied up.

Cycle Components	Days
Days Holding Inventory	80
Days Account Receivable	70
OCC	150
Days Account Payable	(30)
CCC	120
Operating Expenses	75

You should now interpret the information as follows. The OCC is 150 days, but because the business has 30 days to pay the suppliers, the CCC is 120 days, in other words the cash is only tied up for 120/150 of the time ie 80% of the time.

Like wise for the Operating expense where we assumed a uniform distribution over the period and that some would be paid immediately and some would have to wait for the cycle to finish 150 days, on average it is 75 days or 50% of the OCC

Self-funding tactics – Our OCC Components

Using the ratios in the original income statement we can now answer the following:

1. What amount of cash is needed to finance each unit of sales and
2. What is the amount of cash generated by each ZAR of sales?

Per ZAR Income Statement		with CCC factoring	effective per ZAR
Revenue/Income	1.00		
Cost of Sales	0.60	80% (120/150)	0.48
Operating Expense	0.35	50% (75/150)	0.18
Total Costs	0.95	Cash tied up per 1 ZAR of Sales Revenue	0.66
Profit Before Tax	0.05		
Free Cash generated per ZAR of Sales	0.05	Cash needed for each OCC	0.66

So now we know a lot about our business! And what actions we could use to drive better value

Self-funding tactics – What do we know now

The Cash Generated from 1 ZAR of Sales	By looking at the income statement ratio	0.05
The time in days of your OCC	Calculated from Holdings Inventory Days + Accounts Rec Days	80 + 70 = 150
The CCC time to cycle cash used in the OCC	Calculated from OCC - Accounts Payable Days	150 - 30 = 120
The cash tied up in each OCC for a 1 ZAR Sales Income	Restated IS with CCC factored in for OpEx and Inventory	0.18 + 0.48 = 0.66
Your per cycle growth rate	Free Cash that can be added to the OCC cash requirement	0.05 of 0.66 ~ 7.57%
how many cycles can be completed in a year	Days in Year available divided by OCC	365/150 = 2.43
Assume a productivity factor for safety	90% as a reasonable contingency for strikes etc	2.43 x 0.9 = 2.19
Compounded Annual Self Funded growth Rate	$(1+ SFG)^{OCC\ cycles} - 1) = (1 + 0.0757)^{2.19} -1 =$	17.3%

We have all the information we need now to understand where to put our efforts.

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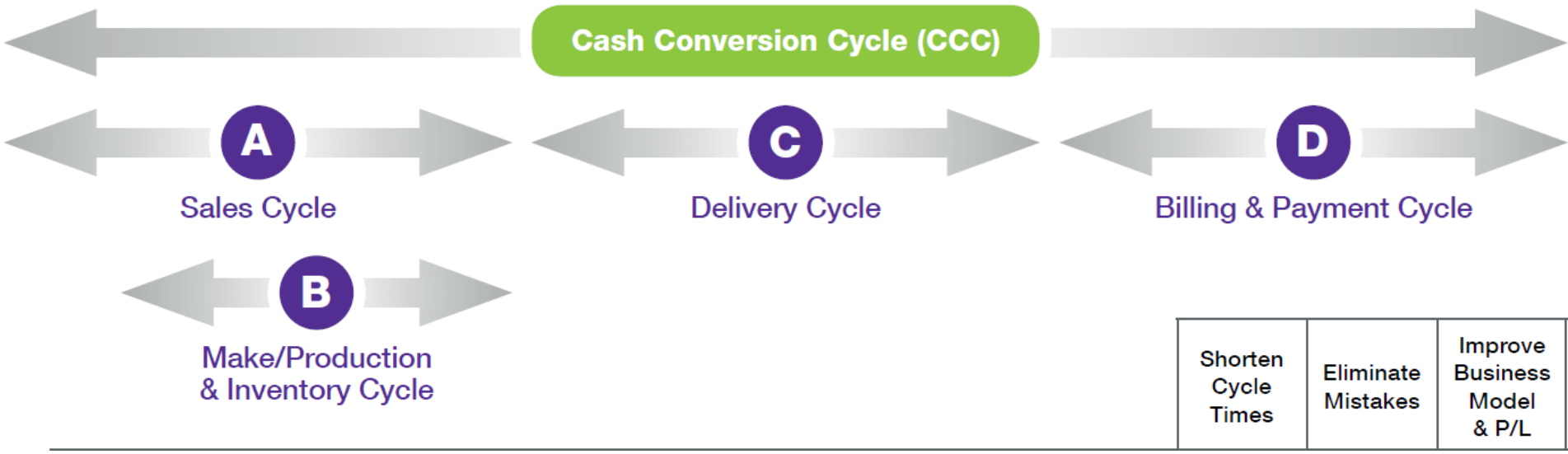
Self-funding tactics – Why understanding this is so important

Any business which is under performing will be looked on warily by creditors!

1. Your extra funding is risk based.
2. And therefore is priced expensively.
3. But you MUST grow to escape your slump
4. And growth requires cash, more than in a steady state!
5. Your plan should adopt as many tactics as possible to allow you to remain self-funding
6. If you are in a Business Rescue, this amount of detail will reassure your creditors
7. Reassured creditors means an approved plan and a better chance of survival.

We cannot over-emphasize the need for ALL businesses to understand their OCC!

Self-funding tactics – Accelerating your cash!



We have a number of opportunities to add value:

1. Raise Prices?
2. Reduce Cost!
3. Change the OCC?
   - Negotiate better terms from suppliers
   - Demand better payment from creditors
   - Improve your internal distribution and manufacturing processes.

Let's demonstrate the power of dealing with just one single opportunity!

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source: http://www.spark-sme-services.co.za/method/Cash/GT_Cash_CASh_unbranded.pdf

Self-funding tactics – Back to our example

The Cash Generated from 1 ZAR of Sales	By looking at the income statement ratio	0.05
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If we just shorten our accounts Receivable days from 70 to 30 days.

1. The OCC is now = 150 - 40 = 110 days
2. CCC is 110-30 = 80days
3. Cash needed for Cost of Sales is = 0.60 * 80/110 = 43 cents
4. We have not targeted operating costs yet = 18 cents
5. Round everything up and we now need 62cents instead of 66 cents (6% improvement)
6. Your per cycle growth rate is 5cents/ 62 cents = 8% growth rate
7. How many cycles can you do in a year now? 365/110 = 3.3 cycles up from 2.43! (36% improvement!)
8. Add a contingency of 95% gives us 3.13 cycles
9. Compounded over a year we now get $(1+ SFG)^{nbr\ of\ cycles} – 1) = (1 +0.08)^{3.1} -1)$ = 26% from 17% originally!

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Understanding self-funded growth is a great exercise in and of itself

We have shown how dealing with one aspect of your business can add value
Imagine if you target all the factors together! (we have more to share but have run out of time today)
So without even removing a single staff salary cost with the 4 tactics in place:

1. We target specific big impact areas of the income statement
2. We make people accountable for delivery of targets on operational value drivers
3. We align the whole business to make sure we succeed
4. We remove waste from the business as per the Value Curve exercise
5. We accelerate cash in the business
6. We account for at least a 25% swing in business result, you should aim for 40%!
7. We don't need extra funding to do this.
8. If you need to downsize then you can resulting in a business result swing > 30% (>50% is possible!)

We cannot over-emphasize the need for ALL businesses to understand their OCC!