Improving Business Performance

In general terms, business performance is about the success of the business and its value to owners or shareholders. Business performance is a more holistic view of business results – much different from the narrower views such as operating performance or financial performance.

Business performance is not a relative measure (to competitors or to itself, year-over-year) but rather an absolute measure based on the potential success of the business. Business performance measures more than just profits or growth but also includes factors that affect the value, worth and liquidity of the business as viewed as an investment asset.

Regardless of how well a business is currently performing, it can always be improved. Returns of twenty-five times the cost of the improvement initiatives are not uncommon, and these initiatives often achieve positive cash flow in a matter of months.

In order to focus on business performance, we must view the business differently – as an investment.

Viewing the Business as a Financial Investment …

Like any investment, the success and sustainability of a business might be inferred by measuring its financial, market and operating results and trends. For owners or investors, the business is best viewed as an investment having a certain value today and perhaps a different value tomorrow.

A business has premium value when it generates profits or throws-off cash as a result of having above average margins and growth. Attractive businesses have strong cash positions - cash reserves, credit lines or retained earnings, allowing them to manage risk or invest in new opportunities.

Good investments also have liquidity – the ability to quickly convert all or a part of the asset into cash or some other financial instrument without substantial discount, and during most economic climates. Above all, a good investment is a persistent predictable performer having minimum volatility and not seen as a financial risk.

To view your business as an investment you must evaluate your business like an investor, rather than just its operating performance.

Measuring its Worth and Value …

The worth and value of a business is determined in part from financial, operating and marketing metrics as well as their trends. Common performance measures include:

Common Performance Components …

- Revenue – new sources and existing market share
- Margins, Profitability or Return(s) – rate of return on the investments

- Cash – accumulation, availability and retention of cash, and debt reduction
- Value – leverage book value by making the business attractive
- Liquidity – M&A, investment or exit
- Stability – persistence, risk reduction, consistency of performance
- Market Share – dominance over the competition

Business development, performance assessment or improvement efforts, seeks ways to determine and improve these metrics. Measuring, comparing and analyzing these components is the basis to quickly identify subtle business problems; these measure can also be used to monitor or trend the progress and success of improvement initiatives.

Business performance improvement is not just about cost cutting or stimulating sales, *it's about rethinking what the business is doing, and how it is doing it, then finding better ways to satisfy the needs of the market.*

However, the Devil is in the Details …

Businesses are often managed at the summary level (P&L and Balance Sheet). Unfortunately, strengths or weaknesses at lower levels within the organization are not always apparent at the summary level; in fact they are more often masked. To identify strengths and weaknesses of the business at an early stage, summary results must be parsed into meaningful components and individually analyzed, to confirm that each is contributing its share to the success of the business – this requires a detailed analysis of the business. Often strong results in one area can hide poor performance in other areas.

Trending performance results year-over-year is another trap. Doing well is not relative a business's history but rather it is relative to the competitive market or the potential of the business to succeed.

Typically, businesses periodically monitor their operating results, not their changing worth and value. If a business is viewed as an investment, management would strive to always maintain maximum value, worth and liquidity.

So why does Business Performance Deteriorate over Time? …

All businesses will naturally deteriorate over their life, when they do not evolve with changing markets, economies, technologies and competitive practices – this is their changing business environment. In a world of global competition and unlimited market reach, continuous change is the only true constant. Businesses will naturally deteriorate when they fail to seek-out, recognize, anticipate and adapt to change.

Generally speaking, external change (market, regulatory, etc.) is easier for management to recognize and handle. However, surveys of deteriorating or failed businesses have shown that 90% had problems that were internally caused and avoidable and those problems were within the control of its management. Typically, the underlying causes of business failure are the failures to anticipate, recognize, adapt or execute, in the face of a growing challenge, during periods of change (especially gradual change). The symptoms are not recognized, the problems are not understood, the best next-steps are not clear, so there is generally a failure to respond to the challenge – a failure to execute.

As businesses get older, especially those that have had success early in their life, often lock into their 'unique way of doing business'. Over time, competitors and even start-ups find ways to compete and grab market share, especially in lucrative markets, through lower costs, innovation and responding better to the evolving needs of shifting markets.

Thus, the imperative of every successful enterprise is the same: to identify and resolve business performance problems early, whether large or small, that could eventually erode success of the investment. Create an organizational culture and controls that seeks out and mitigates threats and weakness, and embraces constant change, innovation and continuous improvement.

But what changes are needed and how should they be made?

Business Improvement …

The most common problem areas within the organization also represent the greatest opportunities to make quick and significant performance or growth improvements. The general areas include: strategy alignment, marketing practices, organization and operations. Within each of these areas, there are commonly occurring operational or tactical problems having well recognized symptoms (e.g. Symptom = customer complaints) of common problems (e.g. Problem = late deliveries) which can easily be measured and verified. Further analysis might expose the cause (e.g. Cause= bad delivery estimates) and root cause (e.g. procedure or formula to calculate delivery is not correct).

Because a well defined problem is more than 50% solved, many organizations can successfully implement their own improvements and the success of those improvements can be measured and monitored in the future.

Many performance deficiencies are well hidden in the organization and within its policies and procedures - sometimes the cause is tangential to where the symptoms or effects occur.

> E.g.: depleting cash might be caused by an inventory problem, whose root cause is inaccurate sales forecasting.

Organizations that typically manage at the summary level often fail to notice growing weaknesses that are gradually developing at lower levels in the organization.

Problems are not easily seen at the executive level or by using summary reports / data. The devil is always in the details. Often, as performance data is aggregated, underlying problems become less evident. In other cases, there might be a tendency to deal with symptoms of weakness rather than the root cause.

> For example: a company might be reporting an average performing gross margin. However when the summary data is disaggregated, such as looking at the individual product or customer profitability and their trends, we might find that the whole can be separated into three classes of performance – excellent (stars), average (cows or ?) and losers (dogs).

One might think that by eliminating the losers, performance will improve; but …

- Perhaps making that change, also changes the nature of the problem
- Eliminating loser products might conflict with other organizational principles such as business or marketing strategy - 'one stop shopping', driving in customer traffic
- Eliminating losers might create new losers, as overhead costs are reallocated to the remaining products
- Maybe the real problem is high operating costs.

Regardless, the improvement effort must focus on isolating and resolving the underperforming aspects of the business.

As for identifying the root cause, one must ask, why didn't the organization or its control methods detect these weaknesses?

The Business Improvement Process …

Like a 'check-up' or inspection and preventative maintenance, a periodic review of the business can identify opportunities to improve business performance. The improvement process has three phases, as detailed below:

Phase 1 - The Assessment …

The Assessment is the most difficult phase of performance improvement, requiring the highest level of skill and experience. Properly done, the assessment will have minimum impact or disruption to the organization taking only about two weeks to complete. The result of the assessment is to identify discrete problems (basic root cause) and the metrics used to identify and monitor them and the control deficiencies that overlooked them.

The assessment might involve about eight management interviews (the second level of management) and targeted subordinate managers. Operational and financial data / reposts will be reviewed, as well as current marketing, HR and operational documentation and any prior audits or reviews. ISO-900x and SOP documentation is also quite helpful. In addition, the organization should have resources to participate in the assessment and research and respond to detailed performance and operational questions, as they arise.

For a typical single location business (< 50MM revenue), an assessment is often completed in about two weeks.

Phase 2 - Designing the solution(s) …

Developing the solution is the trickiest phase. Solutions should be narrowly defined as to minimize risk by not changing the problem(s), having unforeseen consequences or excessive connections to other parts of the business. The solutions should be agile as to keep future option in mind without expanding the scope. The solution details the changes that must be implemented and the sequence of steps of that implementation.

The solutions should be laid out to minimize risk and the implementation scheduled at a rate that the organization can implement and absorbed.

For a typical single location business (< 50MM revenue), a solution can often be developed in about four weeks.

Phase 3 - Implementing change …

A well defined problem and well a well developed solution is a problem more than half solved. In many organizations, there is sufficient excess capacity to learn and implement the required changes. In most cases it is wise to have that implementation and outcome monitored to validate the success of the improvements.

Resources …

Most organizations have sufficient business and industry experience, albeit perhaps dated. Often what is lacking are available resources that are objective, politically independent with a totally focused approach, benefiting from extensive improvement experience, having exposure to a wide range of best-practices from many industries, that might be applied to the situation.

M.F. Smith can help …

Whether you seek an assessment, guidance or support, the focus of M.F. Smith has been on the business of running and improving businesses. Since 1978 we have been serving corporations of all sizes and in a wide variety of industries, in their effort to improve the performance of their organization.

To learn more, contact me for a no-cost, no-obligation confidential discussion about your situation, and how M.F. Smith can help.

Please call me direct at: +1 (908) 328-7540; I *promise*, it will be worth your time.

Michael Smith