

# DELIVER ROI

HOW TO ACHIEVE SUPERIOR RETURN ON INVESTMENT BY FOCUSING ON MEETING THE MARKET NEEDS WITH EVER-INCREASING LEVELS OF SKILLS.

JASON FURNESS

In a commercial enterprise we measure the value created by looking at how much money the business can make. There is a continual rallying cry: 'Make more Money!'

Stock prices, bonuses, remuneration, continued employment, acquisitions, closures, etc., are all driven by how much money we are making now, or think we can make into the future.

But how do we measure money making?

My deeply held conviction is to focus on the return on investment that the enterprise is delivering back to its owners. And I believe you need to keep it very simple in terms of how you measure it.

Many businesses use complex accounting software and some very complicated methods in order to calculate their profit. 'Net Profit' in accounting terms is very confusing to many SME businesses. They look at the number that their accountant says is their profit and ask: "Where is it then, because I don't have that money!?"

So I would argue strongly that accounting profit is not the best measure to use.

Corporations often divide their entities up into individual business units and give each unit an EBIT or EBITDA target to hit. This causes some huge problems, as the behaviours that chasing the best EBITDA at your local operating unit can cause, will actually hurt the business when examined as a single unit.

If you look at business failures, in most cases the business was making some sort of accounting profit, or EBITDA. So why did the business fail?

The reason most businesses fail is that they run out of cash.

If this is why they fail, then surely it makes common sense to focus on cash generation from operations as the major financial goal for business performance.

If what we are looking for is to improve performance of the business as a whole then it also follows that we should look at cash generation from operations for the entire business, not just one operating unit.

We need to be able to see the total cash generated by the business operations over the period of time we are assessing performance. Your CFO or accountant can give you this information.

A business also has cash tied up in its assets, so that it has the equipment, stock, etc neces-

sary to allow it to function. These are the 'Net Assets' of the business; again your CFO or accountant can give you this information.

When you deposit money into a bank you expect to be paid interest in return for allowing them to use your funds. Likewise, shareholders give money to the company and expect a return. To calculate this return on investment (ROI) is quite simple:

ROI = Cash Generated From Business Operations.

## Net assets

Whatever your ROI is, it doesn't matter, your focus will be different. What's most important is that you know what you have to do next to progress up to the next rung.

**"What's most important is that you know what you have to do next to progress up to the next rung."**

Our focus is to boost our ROI from wherever it is today and lift it to at least 5-15% in the first instance and then to 30% and beyond.

## ROI negative

If your return on investment is negative, you're losing money, which means what you are really in is a fight for life. Your day is an all-consuming battle, hoping something changes that will give you a chance to breathe. You almost dread every phone call in case it's from the bank (or anyone else who is owed money).

The owner is totally focused on trying to make sure that if they did have to shut down that they could keep their house. If employees know what's going on, they are terrified of losing their jobs as that may well mean that they are at risk of losing the roof over their heads.

None of this is fun for anyone involved. It is high-stress, energy sapping and terrible for relationships both within the workplace and at home for everyone involved.

## ROI zero to 2%

At zero to two percent it gets slightly better - but here we are still hand-to-mouth and are really

focused on how to survive the week. Can I pay the wages this week? Will I be able to pay the creditors at the end of the month? Your cash flow is incredibly tight, you rely on customers paying on time or else you are down to the bank for an overdraft extension. Your bank will become tired of this behaviour and your credit rating can suffer.

## ROI 2% - 5%

At two to five percent you've got some money coming in. The business has some value and a future. The business model seems to be working. You still need customers (especially large ones) to pay on time. Money has been invested into assets. These assets are probably not running at full capacity. You really need to grow. Here it's about sell, deliver, repeat, sell, deliver, repeat ... and keep growing. Business owners are probably still working long hours and everyone is thinking 'How do I squeeze the last little bit out of my bank account and my overdraft?' It is cookie-cutter stuff.

## ROI 5% - 15%

Between five and 15 per cent is where you start reaping a harvest from all your labours. If you're smart, you make sure you pay down all your debt and start to build a nest egg for whatever it is you want to do.

This is the absolute bare minimum you must tolerate as a return on investment. Here's why. If you go into any of the major banks and say, "Look, I'm just going to sell everything up and I'm going to put it all in a term deposit with you, fly up to Cairns and sip pinacoladas on the beach", what will you get? For all that extra stress of sipping pinacoladas your bank will give you somewhere between four-and-a-half and five-and-a-half per cent interest on your investment.

Now, I know we all love being in manufacturing because of the real reason that it's so much fun. We love turning up every day to deal with people issues, fix breakdowns, chase suppliers and customers (and get chased by customers!). It's so much fun we all do it for love (yes, I am typing this with my tongue firmly planted in my cheek).

If you agree with my ROI premise, then hopefully you agree you're in business not just for love, but you also want a much bigger ROI than you're going to get out of just putting

that money in the bank. For those of you who are looking to borrow money to expand or to win investment funding from other divisions in your company, this is essential. If you're not matching up with what they can get sitting in the bank and doing nothing, you need to change that situation very, very quickly.

At 5 to 15 per cent, you're harvesting cash and starting to build a nest egg. I wouldn't say you're a very plump, well-fed cash cow just yet, but at the very least you're generating cash. At this level the business is still vulnerable to shocks. Your customers can easily find someone else to supply them. A change in pricing can hurt you. In the early stages of cash harvesting, you really haven't got anything in reserve.

**ROI 15%-30%**

At 15% to 30% return on investment you are finally beginning to experience the luxury of having choices. You have hopefully accumulated enough of a nest egg so that you can ride out several downturns in the market. This level of ROI allows us to cope with the inevitable low periods of the economic cycle.

Do I want to expand? Do I want to sell? Do I actually just want to cut back to three days a week and make sure it all keeps ticking over, because I've built a team that can run it all? I'll go play golf or whatever it is I want to do if I am the owner.

If you are the executive employee in this story, then you are almost certainly in line for promotions and expanded roles. Even if the company did get sold, the new owners are going to think very carefully before making you change things away from what you believe is appropriate. You can expect more freedom in your decision-making.



Figure 1.

**ROI 30%+**

A business that is making returns of over 30% (and yes they do exist, I work with a number of them) is a business that is truly in charge of its own financial destiny.

This business is ripe to fully implement the transformational projects to completely regenerate its activities to remain the market leader it has almost certainly become.

After a few years of performance at this level the owner usually begins to think of starting other enterprises using the accumulated returns, spending more time on other projects, or transitioning the management team from one group to the next or intergenerational handover in family owned businesses.

Businesses who are achieving this level of return are often happy with the current situation (why wouldn't you be). The danger here is the risk of complacency and personnel turnover gradually winding back performance. The opportunity is to really go and make something that is truly unique and game-changing in the industry.

So how do we achieve that? Have a look at Figure 1.

**Problems and solutions**

Commerce has always been, and will always be about the creation and exchange of value between two parties.

**Client problems**

Our highest purpose in this commercial exchange is to give the individual client what THEY value in a commercially sensible way from US. Each client is unique. They all have their own peculiarities and individual desires. This applies not just to supplying value to individual consumers (business-to-consumer, or B2C), but also in the business-to-business (B2B) environment. Most of us know that individual companies have their own unique needs and idiosyncrasies.

What creates value for these individual clients is that they have problems. Often they'll tell us those problems in great detail, particularly when we're part of it, but in plenty of situations they won't know the problems they've got. They'll know how they feel about it but they won't really know what the cause is. That happens as well. For example, no one knew they needed a mobile phone in Australia until 1987 when the first commercial service began. Everyone found a way to communicate and accepted the limitations of ordinary phone systems. They did, however, desire a way of communicating without being tied to a landline.

**Industry problems**

When an industry causes a large number of its clients the same style of problem, what we have is an industry problem.

apicsAU

Your Essential Partner in the Quest for Supply Chain Excellence

apicsAU

The Society for Supply Chain Professionals

Membership with apicsAU provides an education and career pathway for companies and individuals who are serious about supply chain improvement. Open the door to expertise and knowledge with our programs, network opportunities and mentoring. Boost company and personal performance with internationally recognised industry certifications and nationally recognised qualifications.

apicsau.org.au

CONTACT YOUR STATE CHAPTER FOR ENROLMENT DETAILS:

apicsAU NSW  
T: 02 9891 1411  
E: enquiries@apicsau.org.au

apicsAU QLD  
T: 1300 957 952  
E: qld@apicsau.org.au

apicsAU SA  
T: 1300 557 175  
E: sa@apicsau.org.au

apicsAU VIC  
T: 03 9328 4477  
E: victoria@apicsau.org.au

apicsAU WA  
T: 1300 557 175  
E: wa@apicsau.org.au



An industry problem is something that is experienced by the whole sector. For example, if you ring up and try to have an electrician, plumber, or carpenter come to your house to do some work and arrange a specific time for this, you may run into an industry problem. The stereotype of the industry is you can't get them to turn up to quote and you can't confirm an appointment time. In fact, they often won't turn up at all, and if they do, they'll tromp muddy boots through the front of your house.

Not all electricians, plumbers, carpenters are like this but enough are so that this is an example of how the industry as a whole hurts its clients.

#### **Business process**

The third circle represents us! Our business processes. This is what we actually have control over. The circle includes all of the activities inside our business.

What's of most interest to you (and what you should obsess about understanding) is how your business processes interact with the industry problems and problems of individual clients.

#### **Growth**

Now, where my business processes overlap with an industry problem, I am going to get growth because I'm solving a problem that everyone experiences. If I can turn up on time and be reliable as a tradesperson, I'm going to get growth; I'm going to get business, because so

many of my competitors don't. This is still a powerful business model today.

#### **Opportunity**

Where there's overlap between a client problem and an industry problem, there's clearly an opportunity in the way you work with those people that you are not currently using.

#### **Loyalty**

Where my business process solves the unique needs of a particular company, then I am highly likely to receive increased loyalty and repeat business. This is very valuable not just for their business, but for the referrals and recommendations it can generate.

#### **Transformation**

The overlap point of three circles is where you can achieve real and sustainable transformation. If I'm solving someone's individual problems, I've covered all the industry issues and my business process has nailed it, then that's where we transform our business very, very rapidly.

Say your clients value short lead time to market, the industry problem is long lead time to market, and you can fix this by adjusting your business process; boom, you're off and running.

If the problem in your industry is high price and low quality and you're able to solve that problem when no one else in the industry can - boom!

The whole concept of patents or the whole commercial value of patents is that you're

solving some issue in a way that excludes and separates you from the rest of your industry. There's a reason we pay more money for things that someone's invented and patented, because we can't get any other competitive dynamic in there until we invent an alternative.

#### **Waste**

But is that enough? No, because under all of this there's one thing, one key thing for all of you in all your businesses.

We exist as a viable commercial entity to create value for customers and our stakeholders. We do that by having as many of our business processes as possible overlapping (solving) both the client problems and the industry problems. The business processes that add value in this diagram are those processes that intersect one or both of the other circles.

If your business process doesn't intersect with either circle, then it doesn't add value. So why are you doing it? Most often it's because you have to respond to legal, financial and compliance issues. Customers don't want to pay for your compliance work, but it has to get done. But compliance work is actually a gold mine of opportunities to move more of your business process into the intersection of the circles.

**Jason Furness is the CEO of manufacturerShip. For more information call 1300 226 121 or email [jason@manufacturerShip.com](mailto:jason@manufacturerShip.com). You can also sign up at [www.manufacturerShip.com](http://www.manufacturerShip.com) to receive regular updates on manufacturerShip programs, thinking, and work. *mhd***