

Circular Organization Focuses on Cash, Not Personalities

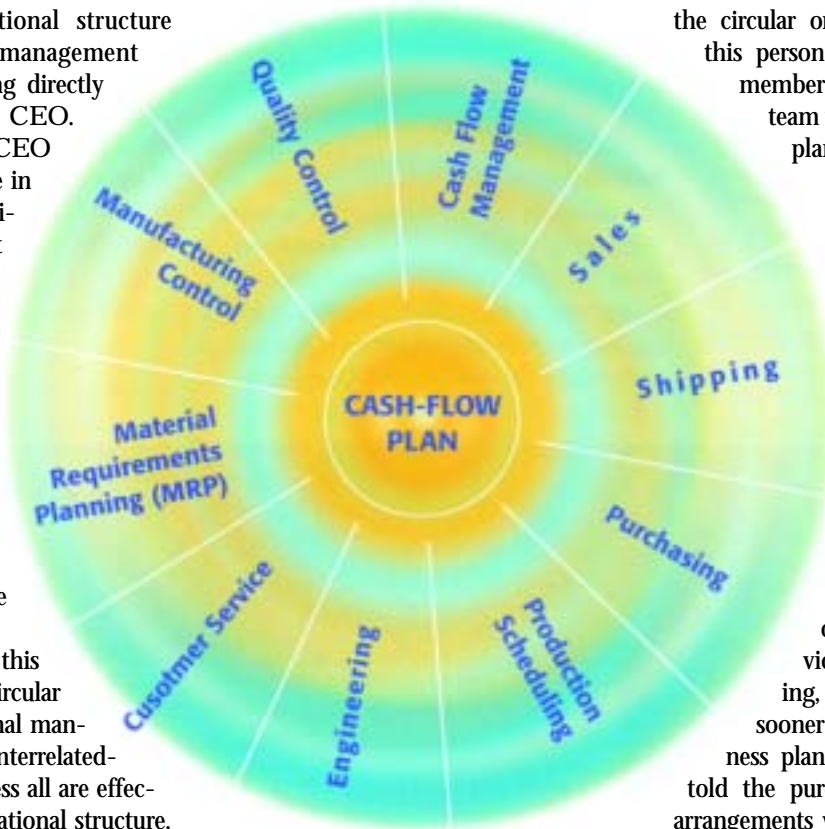
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A typical organizational structure shows all key management positions reporting directly to a company's CEO.

This means that if the CEO decides to make a change in the operations of the business, he may not inform all the appropriate people who report to him directly of his decision. Oftentimes, this lack of communication to management team members could mean that not everyone is on the same page in terms of coordinating what must be done to drive the business plan results.

The way to overcome this problem is to establish a circular organization. All functional management activities are interrelated—one can't be effective unless all are effective. In a circular organizational structure, performance metrics are driven and decisions are based on answering the question, "What impact will this decision have on cash flow?" The circular organization is an effective turnaround tool because it focuses on cash while removing personalities from decision-making.

To the extent that variances occur in the performance metrics established, the CPO



or controller - the only person who sees and can understand all implications of the receipts and disbursements of cash - must capture the variance data, determine its impact on achieving the business plan or cash-flow targets, and provide feedback to the functional team members. As a result, the CFO or controller is at the center of

the circular organization. Working with this person, other management team members must provide the overall team with action items to address plan variances.

The lack of communication that can occur in a typical vertical structure can create serious problems. For example, the CEO of a manufacturer of film laminates decided to change his company's manufacturing cycle because customers were not getting fast enough turnaround on their orders. To fix that problem, the CEO told one of his direct reports, the vice president of manufacturing, to bring materials in much sooner than called for in the business plan. That vice president then told the purchasing manager to make arrangements with key vendors to deliver the raw materials sooner.

As a direct consequence of this action, the company's revolving line of credit at the bank veered out of formula. The controller had presented the bank with a business plan that showed peak sales in September, which led to declining inventories and increasing accounts receivable. Prior to September, inventory was at its

peak, along with inventory borrowing. In November, when the bulk of the receivables had usually been collected, the loan balance would normally be paid down to zero, which is what the bank expected.

Instead, because of the CEO's unilateral decision to shorten the lead-time on deliveries to his customers, raw materials inventory was brought in sooner. Conversion to work-in-process (WIP) took place sooner, as did the conversion of inventory and the collection of receivables. As a result, the normal financing cycle did not follow the historic borrowing base calculation. In November, when the loan should have been paid out, it instead was increasing as a result of bringing in inventory to fill the next order cycle.

This case demonstrates a major weakness of typical vertical reporting structures. To shorten the lead-time on deliveries, all the CEO needed to do was to tell his vice president of manufacturing, who reported directly to him. The vice president, in turn, told the Purchasing manager, who reported directly to him. The problem, of course, was that the controller was left out of the loop.

The controller was responsible for interfacing with the bank and making sure the borrowing base formula was met, but he had no idea that the CEO had changed the purchasing and inventory cycle. As a result, he never told the bank and was unable to explain to the lender why the loan was at its peak in November, when it should have been paid down to zero.

The Management Team

The circular organization calls for monitoring performance metrics to allow a management team to drive the business plan results. Once a business plan has been prepared, including a detailed 12-month cash flow, income statement, and balance sheet, performance metrics must be established.

To measure these performance metrics, a company must establish functional responsibilities within the organization. Depending on the nature of the business, these functional responsibilities may include sales, order processing, purchasing, production scheduling, manufacturing,

information systems, quality control, engineering, shipping, customer service, and cash-flow management.

After functional areas have been established and performance metrics have been identified for each, management must identify someone who will be held accountable for managing each functional area. These management team members are critical to the success of the plan. Therefore, senior management must pick as key functional managers people who have the greatest ability to control, manage, and report on their functional areas of responsibility.

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This includes the CEO, who also must have a functional responsibility. For example, if the top executive is responsible for achieving the sales and order backlog included in the plan, then the CEO will report on that functional area at staff meetings and will be held accountable for achieving performance metrics established for that area.

Managers who are named to oversee functional areas must buy into the performance metrics being used for their areas of responsibility. Because these managers will be held accountable for achieving the specific metrics included in the business plan and cash-flow projections, the plan cannot be put in place without their sign-off on performance metric assumptions used in the plan.

Once they buy into the performance metrics, they must take responsibility as a team to drive the business plan results by driving the performance metrics.

The team's responsibility is to plan, organize, direct, monitor, and control the plan results. The team must direct activities that fulfill the expectations of the busi-

ness plan metrics and monitor the results to determine if the business plan is proceeding as planned. Finally, it needs to control and analyze metric and cash flow variances and make sure line managers are carrying out their responsibilities properly.

The management team controls the plan results by assigning specific functions to specific members of the team, along with responsibility and authority to carry out those functions. To accomplish this, the management team must share information about financial performance and accomplishments and disappointments. In addition, it must share decision making authority.

Further, one member of the management team must be held accountable for overseeing the realization of the cash-flow plan. This means that any variances or changes to the cash-flow plan must be reviewed by this team member to determine the impact of proposed changes on the overall cash flow plan results.

Once a business plan and a detailed cash flow have been developed and approved and key functional managers have signed off on their performance metrics within the plan, the next step is to set up weekly staff meetings for the key functional managers. Agendas should list all attendees by name and the functional areas to be discussed, along with the name of the person responsible.

At the initial meeting, each functional manager should hand out written materials detailing the status of the agenda item being discussed. For example, the functional manager responsible for order backlog should hand out a list that includes the names of customers in backlog, the products ordered, their sales value, the expected delivery dates, and any deposits received. The manager may then wish to discuss with the engineering team member design changes that are required for processing an order, a timetable to accomplish the task, and the impact on the company's ability to meet the expected delivery dates.

The materials manager might then enter the discussion to verify the parts that will be needed, along with their lead times to determine if all parts will be available on schedule to meet the needs of manufacturing.

The manufacturing manager might discuss the timetable for completing this order given the existing production schedule, manpower availability, and other shop floor problems that may exist.

As a result of these discussions, a list of action items is created, which requires the appropriate functional managers to meet between staff meetings to resolve differences or work out issues between departments. After the initial weekly meeting, all subsequent regular staff meetings should begin with a review of the action items from the previous meeting to make sure that no issues are lost or overlooked.

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In the Loop

Had the CEO of the film laminates company been working within a circular organization structure, the company's

experience likely would have been different. The controller would have been responsible for cash-flow management, including the effect the CEO's change to the business plan had on the cash flow. The cash at stake in that case was the company's existing line of credit with the bank.

The CEO, whose functional responsibility within the company was achieving sales targets, would have discussed with his functional management team, including the controller, his need to shorten lead times on deliveries to meet his sales targets. He would have asked the materials manager if the

company could realistically change its vendor delivery dates to bring materials in sooner. The controller or the CEO would have questioned whether such a change would impact the cash-flow plan.

Under a circular organizational structure, the controller, whose functional responsibility for cash management

included the borrowing base and bank relations, would not have been out of the decision loop. He would have determined the impact on the borrowing base, and the management team could have discussed how to manage the company's cash to ensure sufficient availability under the borrowing base to accommodate this decision.

The bank would have been told about the changes and would have become involved in approving a change to the borrowing base before the decision was made so the company would not go into default.

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