

Principles...

This week, as I make decisions, I will choose the options that align us more closely with these Principles, and aid the Company's **Prime Directive to: "Create more free cash flow this year than last, year after year, to ensure the Company's economic survival, generation after generation."**

To achieve the Prime Directive, you travel through each week hunting for and exploiting opportunities to 1) Increase Customer Value, 2) Increase Sales, 3) Increase Gross Margin, and 4) Reduce Expenses – The Business Tetrad.

Begin by creating (or updating if needed) a written business model, niche statement, and list of competitive advantages.

I. Customer Value – Focus our business on superior customer value.

- A. Know our customer's goals and problems well enough to refine our business model to provide products and services of high value to them.
- B. Aggressively invest in those things that allow us to deliver higher value to our customers than our competitors do.
- C. Ensure everyone continually obsesses over customer satisfaction. Exceed customer expectations.
- D. Measure the quality of our product and service:
 1. In-process Quality Assurance (QA) checks.
 2. Customer Complaints.
 3. Late deliveries.
 4. Customer retention (and know why your customers leave you).
 5. Presentation competence at customer touch points (win factor).

II. Sales – Develop a formula for increasing sales. Aim for Double-Digit Growth.

- A. Typical "Organic Growth" formulas include one or more of the following:
 1. Ramping up an outbound sales force.
 2. Adding new products or services.
 3. Entering new markets.
 4. Outspending your competition on advertising / marketing / PR.
- B. In addition to 1) pursuing new customers, develop a strategy to 2) sell more to current customers, and 3) get larger-volume customers. But don't permit a "customer concentration" problem.
- C. Ride a burgeon
 1. Position the business to operate in "markets with great disparity" between what was, and what will be. – *Drucker, circa 1970*
 2. Keep maneuvering the business into growing, long-term sustainable markets.
- D. Work our growth formula as aggressively as we are able, without hurting our goals of:
 1. Privately held.
 2. Cash profitable.
 3. Internally financed, except for large capital expenditures.
 4. Competent supervisors at all levels and in all pockets of the business.
- E. Monitor sales 1) Quoted, 2) Booked, 3) Produced, and 4) Invoiced, compared to Initial Break Even (I B/E).
- F. Plug all leaks in the revenue cycle that cause a variance between "Earned gross sales" and "Realized sales."
- G. Push to invoice customers as soon as possible, as much as possible.
 1. Collect receivables faster. Strive for pre-payment.

III. Margin – Keep our mark-up among the highest in the industry.

- A. Gross Margin = Sales minus cost-of-goods-sold. Produce a Gross Margin report showing which customers, products or activities give you the best margin; and push for more.
- B. With a new company or product launch, prepare a budget showing your fixed expense vs. variable expense; and the dollar amount of sales you need to exceed your Initial Break Even (I B/E).
 1. Race to get sales up above I B/E.
- C. Measure your costs associated with "Waste" like defects, scrap, downtime, overtime, re-work, etc. And drive them down.
- D. There are four ways to produce high margin:
 1. Have the courage to charge more.
 - a. Many examples in luxury and service industries.
 2. Pursue sales opportunities that tolerate higher margin.
 - a. Certain industries, products or buyers will more readily absorb higher costs.
 - b. Strive for "value" pricing vs. "cost-plus" pricing.
 3. Increase the value of your existing product in a way that allows you to charge disproportionately more than the cost.
 4. Lower the cost of producing what you sell, without reducing quality.
 - a. Henry Ford sold cars for less than his competitors, yet maintained a higher Gross Margin by producing them more efficiently.

...For Growing Value...

- E. Before creating a new Initial Break/Even by entering a new market or business, ensure that:
 - 1. We have the entrepreneurial capacity to cover the new activity without harming our existing activities,
 - 2. Sales at existing operations are growing as fast as the market will allow; unless:
 - a. We've crossed the point of diminishing returns in our existing markets.
 - b. The margins in the new market are far superior to our current margins.
 - c. Customer demand in the new market is far superior to our current demand.
- F. Have the wisdom to "No Quote" or reject customers and projects that harm our margin, cash flow or other principles.

IV. Drive down costs.

- A. Force our operating-cost per dollar-of-sales lower than our competitors; and lower this year than last year.
 - 1. Management must model behavior that teaches parsimony and frugality.
 - 2. Outwork our competition – do more work, and better work, with fewer employees.
 - a. High employee efficiency and effectiveness.
 - b. High employee work quality and accuracy.
 - c. Lowest possible employee head count.
 - d. Low employee turnover, especially among key positions.
 - 3. Lock down cash outflow.
 - a. Approach each invoice payable with an "Auditor's Skepticism."
 - b. Follow written "Contracting Guidelines" and "Employee Authorizations" for spending money.
 - c. Teach and follow written "Purchasing Rules" like "Confirm price before authorizing work."
 - d. Ensure error-free payroll processing; resulting in no employees being overpaid or under withheld.
 - 4. Spend company money conservatively e.g. When traveling, or with clients, angle for average-priced restaurants vs. "elite" dining.
 - 5. Have it be true that, "Nobody pays less than us (for the quality we require)."
 - 6. Don't get burned by early-stage, unstable technology. Only upgrade our technology when dysfunctional; or the R.O.I is massive.
 - 7. Minimize activities or expenses that customers or shareholders would not be willing to pay for.
 - a. Don't spend your time doing what others want, if there isn't a strong, near-term benefit to our goals. e.g. sitting on outside boards, to public speaking, to as little as filling out surveys.
 - b. No political activity. Take no side in public controversy. – *Giovanni de 'Medici, circa 1400*
 - c. Limit charitable donations of time or money.
 - d. Shun management comforts – and take pride in it.
- B. Meet deadlines, "On time, every time."
- C. Minimize or eliminate the costs of growth.

Our aim is to be one of the most profitable companies in our industry, for our size. This will require constant attention and adjustment. Our target is a 30% Return On Sales (pre-tax profit).

A 30% return is easiest to achieve when sales are rising, margins are high, operating costs are low, and customer retention is high. (Below a 10% ROS, it is difficult to produce free-cash-flow.)

(Above this line are the four aspects of the business you strive to improve each week – The Business Tetrad. Below this line are the main principles that will help you achieve I, II, III & IV above.)

V. Know Your Facts. Scrutinize results. Develop reports that give us insight into our success at achieving the above-mentioned goals; then scrutinize these financial statements; productivity reports; and quality-assurance reports monthly.

- A. Act on what they tell you to change – in order to achieve the Prime Directive.
- B. Clamor for more: 1) dividends; 2) productivity; 3) product quality and 4) better customer service.
- C. Face our uncomfortable truths. Security comes from confronting the uncomfortable.
- D. Develop a set of Key Performance Indicators (KPI's) that will give you a weekly feel for company performance and profitability.

VI. Innovation and Entrepreneurship – Innovate to expand our Competitive Advantages.

- A. Innovate new and better ways to:
 - 1. Provide value to our customers, 2) Increase Sales, 3) Raise Margin, 4) Lower Expenses.
- B. You'll know you are succeeding at this if you can truthfully quote Rockefeller when he said, "We have ways of making money our competition knows nothing about."
- C. Hammer away at the "Constraints" to your "Fulcrum Activities."
 - 1. Fulcrum Activities, are those few things that, if you could figure out how to do, or do faster, would dramatically improve profitability.

...Of an Investment-Grade...

- D. Once a new Initiative is agreed upon, add it to the Agenda of the most appropriate committee.
- E. Competitive advantages can last years, but seldom decades. The company that fails to innovate is on the path to obsolescence.
- F. Keep a running list of our Innovations and Competitive Advantages, and how we compare to these Principles for Growing Value. Have the management team review this annually for additions and subtractions – what we call an Enterprise Assessment.
- G. When the rate of change inside an institution becomes slower than the rate of change outside, the end is in sight. – *Jack Welch*

VII. **Failure Analysis – “Analyze and profit from our failures.” – *Jim Rand, circa 1920***

- A. Whenever we find ourselves frustrated, in pain, failing at our goals, confronted with a problem, or having made a mistake, we stop the flow of our day.
 - 1. We recognize this as an opportunity to improve the business, and ask:
 - a. What changes can we make to our process, or
 - b. What form, policy, checklist, system or control can we install, or
 - c. What training can we institute, so we don’t repeat this problem in the future?
 - 2. After conducting a Root Cause Analysis, you determine one or more Initiatives to prevent future occurrences.
 - 3. Before the next opportunity to encounter this problem again, we install the permanent solution.
 - 4. The cost of the solution must be less than the cost of the problem.
 - 5. For a company to suffer from the same mistakes, year after year, is the opposite of “Best Practice.”

VIII. **Pursue Initiatives – Install a system that will capture initiatives and drive them to completion.**

- A. The system we recommend is to establish Standing Committees, responsible for important aspects of company performance.
- B. As you travel through your week, each time a new Initiative is identified that could strengthen the business, add it to the Agenda of the most appropriate committee, or an individual’s Action Item List. Don’t remove it until installed.
- C. These committee meetings with their Agenda and Reports, systematically, methodically produce improved company performance.

IX. **Avoid debt.**

- A. “Debt, grinding debt, which consumes so much time, which cripples and disheartens. If you are wise, you will avoid a prosperity which loads you with more debt.” – *Emerson, circa 1850*

X. **Save – stockpile cash – stuff the war chest.**

- A. Feel angry, determined, redoubled resolve any month we don’t create free-cash-flow.
 - 1. It’s the free-cash-flow that allows you to accelerate debt payments, add to safety capital, fund growth, pay dividends, and finance next year’s employee pay raises.
- B. There will always be a next recession, and Black Swan events do happen; at these times Cash is King.
- C. Grow our “Safety Capital” accounts until we reach our targets of:
 - 1. Internally financed Credit Line = 1 gross payroll, minimum.
 - 2. Recessionary Savings = 2 month’s cash needs.
 - 3. Safety Reserve at the Holding Company = 1 month’s cash needs.
 - 4. Sinking Funds and Revolving Funds = as needed.

(If a business is going to be strong, for generations, the Principles below this line become even more important.)

XI. **Establish a “world-class” organization.**

- A. Employ only the best.
 - 1. Attract, hire, and retain top-quartile employees who can build the business better than our current best.
 - 2. Recruit new-hires by using a best-practice hiring system. Don’t just “trust your gut.”
 - 3. Assemble a cohesive leadership team, of managers who are able, in earnest, and reliable.
 - 4. Promote those who demonstrate the *Observable Traits of Management Excellence*, and *LEADERSHIP*.
 - 5. Regarding the caliber of your employees, there is a line. Team members below the line will frustrate and disappoint you. Above the line they’ll surprise and delight you. Not comprehending this line, the consequences, and the steps required to improve, traps underperforming companies where they are.
 - 6. “The unable or unwilling must be removed from the enterprise.” – *Henri Fayol, circa 1900*
- B. Affiliate with the best suppliers and outside service providers.
 - 1. Examples: accountant, legal counsel, product vendors, subcontractors.
 - 2. “Engage those with the best reputation; the most prominent, at the top of their field.” – *Armond Hammer, circa 1950*
 - 3. Reject vendors that are less than “Grade A” – as fast as possible.
- C. Provide tools, equipment, and technology that are good quality, and the most efficient.
- D. Establish Policies and Procedures (P&P) that are considered “Best Practice.”
- E. Occupy facilities that inspire confidence in our customers and enable us to recruit world-class employees. i.e. buildings and furnishings, in neighborhoods that our target job applicants will be proud to show their parents or spouse.

...Privately Held Business

- XII. Company Culture – Establish the correct “Working Climate.” – *Henri Fayol, circa 1900***
- A. “Build a force of enthusiastic, loyal, harmonious co-workers.” – *Harvey Firestone, circa 1920*
 - B. Appropriate “Tension.” The first requirement of organizational health is a high demand on performance. Managers must set high standards for themselves and their teams. – *Drucker, circa 1970*
 - C. Most managers know that insisting on discipline and accountability will make people feel uncomfortable. What usually holds an organization back is the manager’s fear of creating this discomfort. – *Gino Wickman*
 - D. Incentivize to make employees feel the way the company feels.
 - E. Transmit to employees an active, unrelenting drive to affect process improvements promptly, at all levels and in all parts of the business – what the Japanese call KAIZEN.
 - F. Create a culture that celebrates cost saving in every corner of the business.
 1. A good way to achieve this is with a monthly “cost-side-down” meeting and database.
 - G. Involve all employees in keeping our facility organized, orderly and clean – what efficiency experts call “5-S.”
 - H. Treat each other with respect.
 1. Decide in favor of the employee or subordinate when the written policy is unclear.
 2. Thank, praise and compliment daily; to comply with the 4-to-1 rule (Four compliments per criticism).
 3. Model friendly, fair, courteous, compassionate behavior.
 4. We promise our incoming employees a work environment where they will not be subject to:
 - a. Yelling; b. sarcasm or humor at the expense of others; c. profanity or vulgarity; d. group reprimands; e. moodiness or rudeness.
- XIII. Bench Strength – Build a reserve of capable employees who can move up to fill key positions.**
- A. Have at all times at least one subordinate with the ambition, people skills, technical competence and values, who could take over my position today.
 - B. Cause managers to hire “bench strength” even for their star performers and for themselves.
 1. Offer jobs to applicants you believe can grow beyond their starting position with us. To do otherwise runs the risk of not having enough capable employees to fuel our growth or replace outgoing folks in key positions.
 2. Offer jobs to applicants capable of solving all the problems they’ll encounter. We’re flunking if it requires the department head to solve the department’s problems.
 - C. Make room for capable employees who could grow into a larger role at our company, so we don’t lose them.
- XIV. Delegate: effectively; and as necessary.**
- A. Delegate so you can do timely and well, all the things that only you can do.
 - B. A top manager delegating too slowly harms company growth and profit.
 1. If for several months you’ve been unable to get to important responsibilities,
 2. and you’ve determined it is not because of a temporary spike in work,
 3. and company goals are being harmed because you can’t get to everything:
 4. Perform a Work Study by recording your activities during the next several weeks, in half-hour increments.
 5. Individual tasks will present that can be eliminated or parceled out to others.
 6. Sometimes groups of tasks can be batched and assigned to a new position you create.
 - C. Steps to delegate effectively.
 1. Do the job well yourself. 2. Let the other person watch you do it well. 3. Watch them do it until they do it well.
 - D. “The growth of small companies is capped if they don’t install Systems & Controls. These allow you to delegate, yet keep work-quality high.” – *Jon Slabaugh 1998*
 - E. Regarding the company’s strength-giving systems and procedures, “There is always a Gap between how the business operates; and how management thinks it operates.” Your job is to seek out and reduce that Gap.
- XV. Management must set a good example.**
- A. Strive for honesty and high integrity, especially from myself.
 1. This relates to my treatment of employees, customers, suppliers and laws.
 2. Decide in favor of paying less tax this year; but pay happily the tax we do owe.
 3. Don’t take product, office supplies, or equipment home; or use company-paid services for personal benefit.
 4. Lying or deceiving should result in termination.
 5. Promote making high-character choices, as they arise, throughout the company. See “Character Is Destiny” doc.
- XVI. Remember: “We can get everything in life we want, if we just help enough other people get what they want.”**

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