



Golden Oldies

Tales from the Vault of Rowland Chen

From 2015: “Plot an Improvement Path Forward”

The Situation at Acme Services

- A leading oil field services company in 2015
- Three main line items for operating income at Acme: (1) revenue, (2) project costs, and (3) total overhead
- Requirement from private equity owners: \$60 million in operating income for FY16
- Management's latest projection is only \$30 million
- Management must achieve a bottom-line improvement to operating income of \$30 million to close the gap



Plot an Improvement Path Forward

Rowland Chen

September, 2015

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A Contour Map Shows Lines of Equal Elevation

We will use this construct to formulate performance improvement strategies based on **lines of equal profit improvement**.

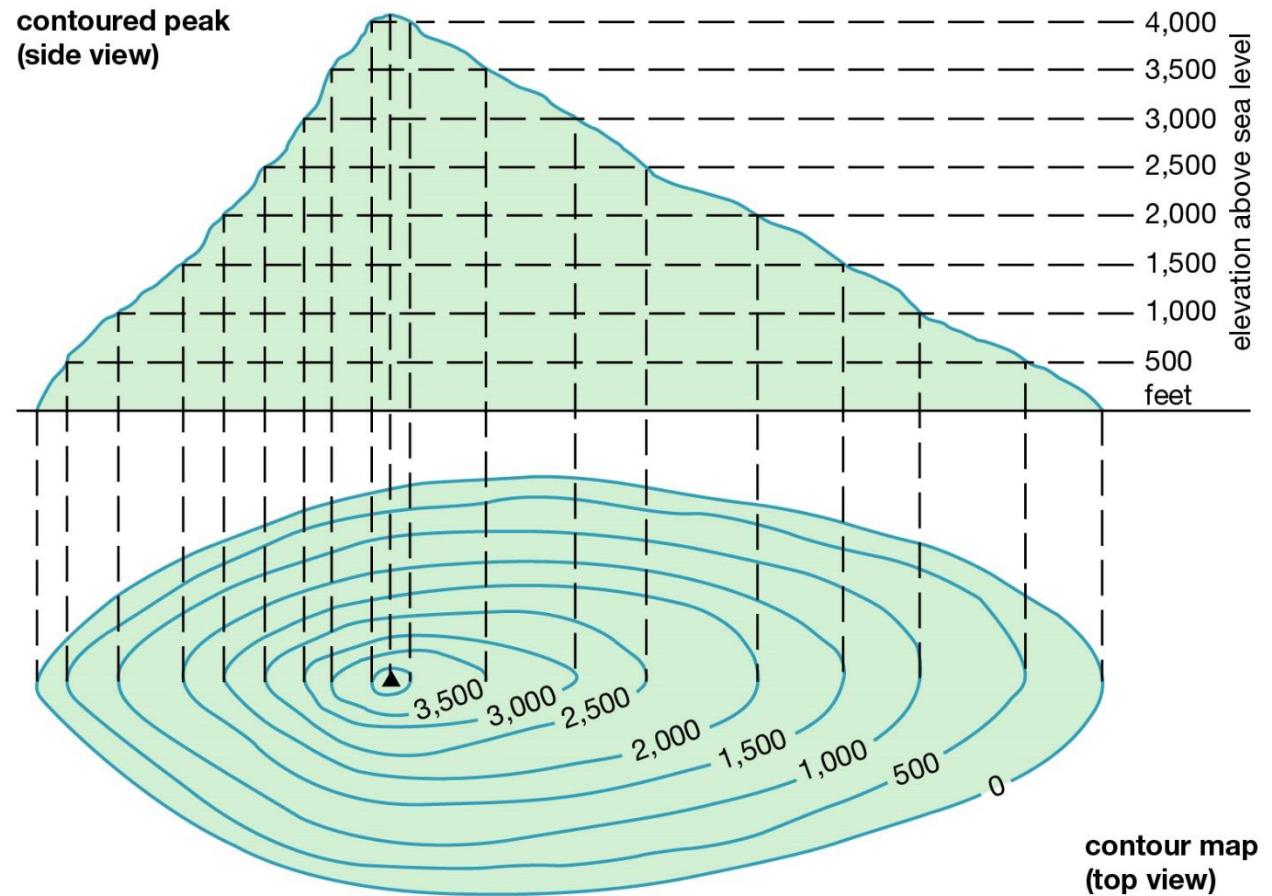


Image source: Encyclopedia Britannica

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Purpose of this Analysis

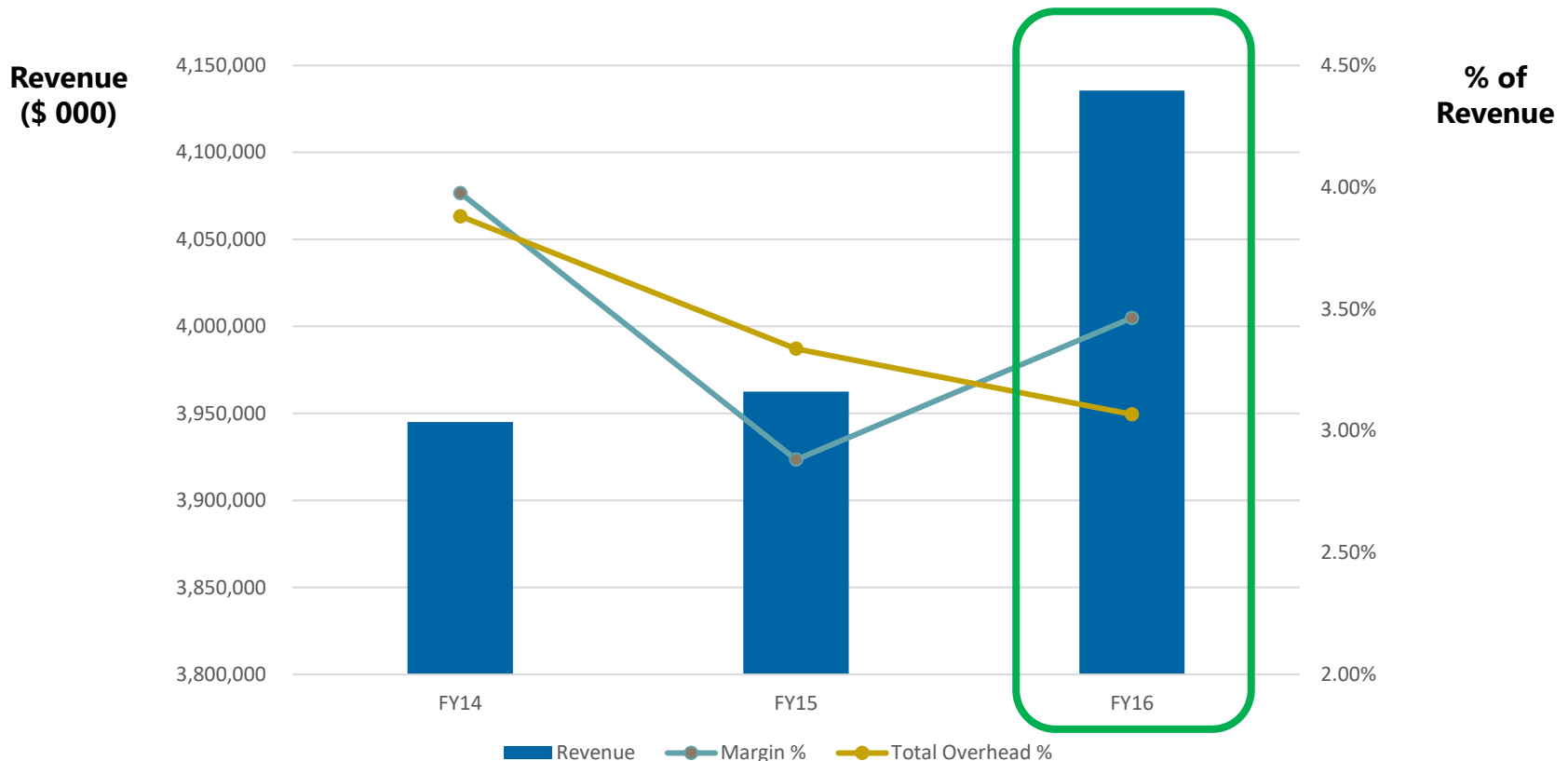
- To take a top-down, broad-stroke view of how to improve projected financial performance
- To decide where Acme Services has the greatest leverage for improving Operating Income in FY16
- To provide senior leadership with a financial improvement “Contour Map” in order to execute a multi-dimensional improvement strategy
- To create a means to show an improvement roadmap to Acme’s owners

Approach

- Scope: Acme Consolidated (total enterprise)
- Use “P06 Projection by Division by Year 2014 to 2016 082715”
- Take FY16 Projection as the baseline
- Analyze three levers of financial performance improvement
 - Revenue increase
 - Project Cost reduction
 - Total Overhead reduction
- Draw financial performance improvement “contour maps”
- Determine a feasible strategy to achieve \$30 million in performance improvement

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Current Plan for FY16: Revenue and Margin Up; Total Overhead - Down



Way beyond a "hockey stick" forecast for revenue. Let's keep in mind, however, **operating income** is Acme's key metric for performance.

FY16 – the Baseline for the Analysis

Line Item	FY16 Projection (000)
Revenue	\$4,135,516
Project Costs	\$3,992,292
Margin	\$143,224
Total Overhead	\$126,851
Operating Income	\$30,161

Three possible levers lift operating income

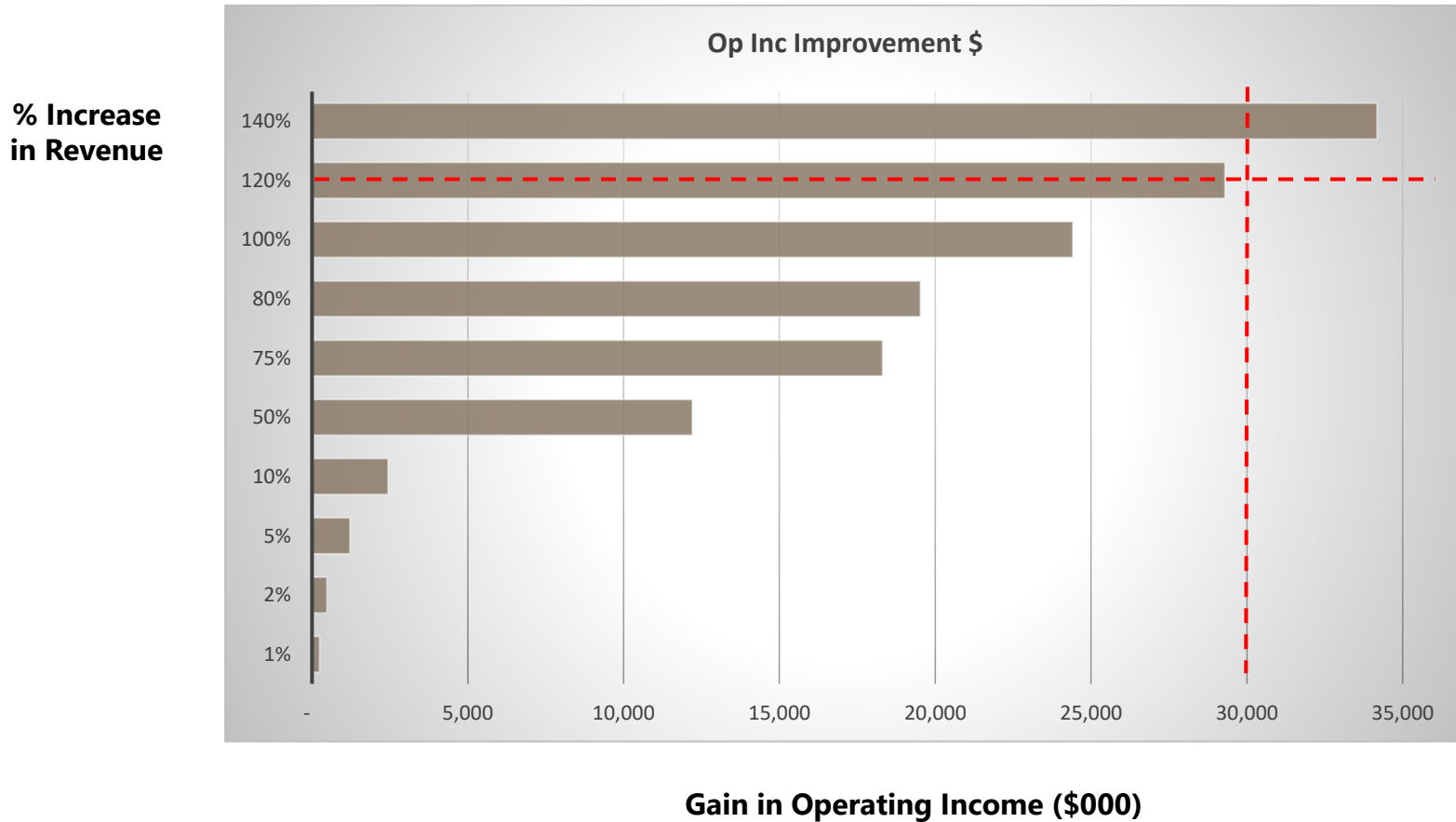


Image source: University of South Florida

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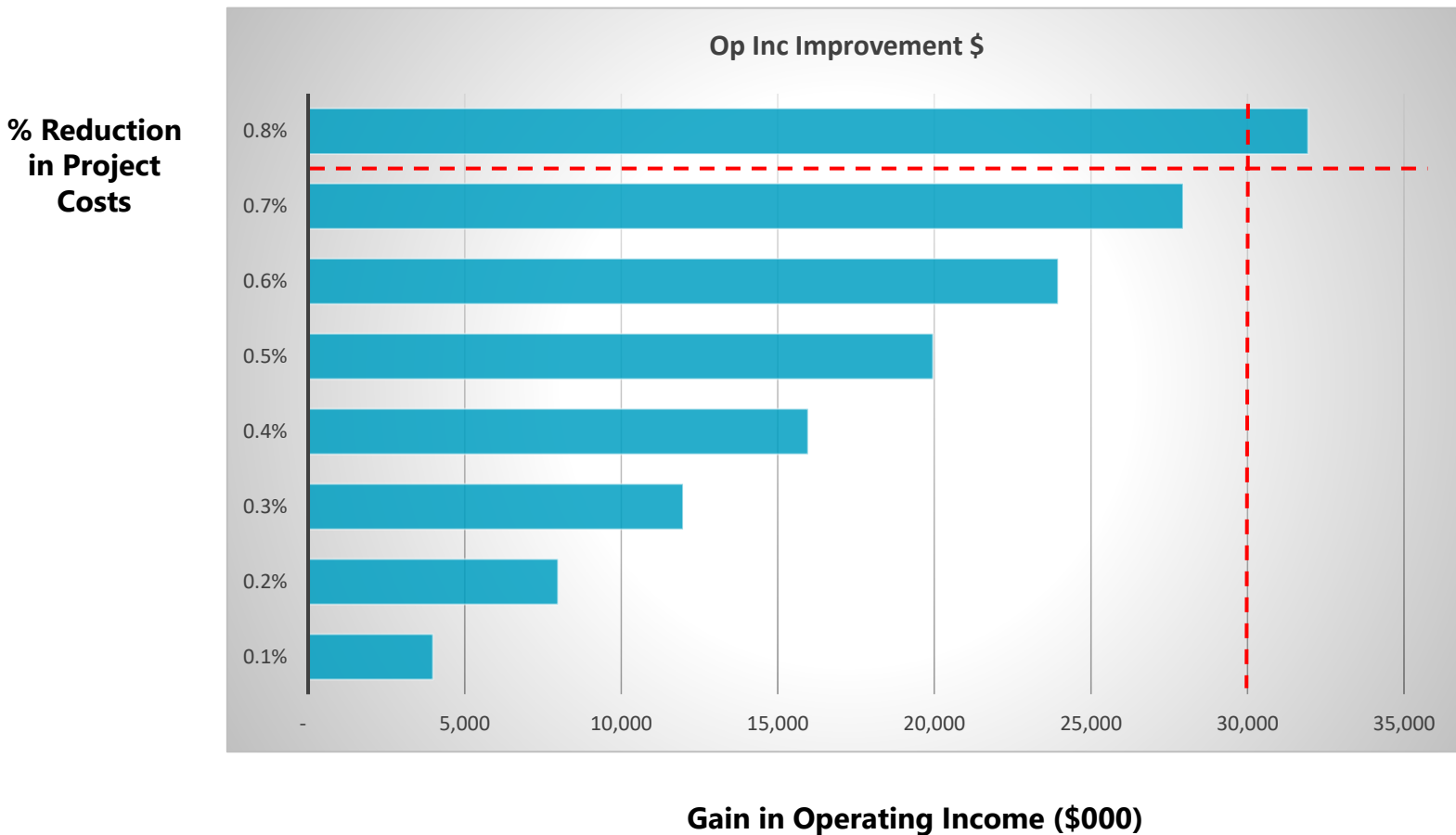
Increase Revenue by Itself – What It Would Take Is Not Feasible

- To achieve a \$30 million impact, we need a 120% increase in revenue.



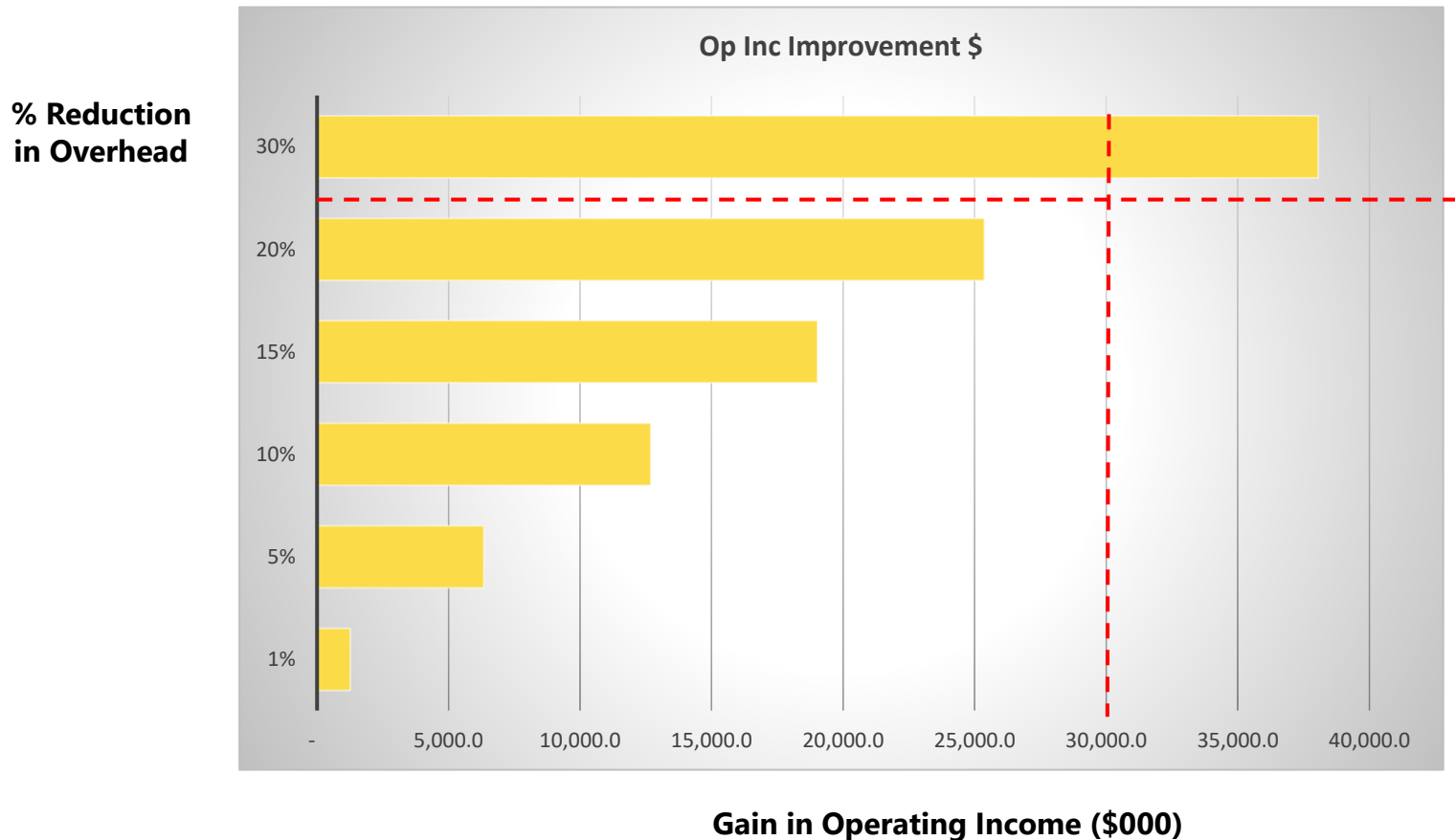
Reduce Project Costs by Themselves

- Reducing Project Costs by 0.75% yields the \$30 million improvement
- Achieve these savings through procurement and project execution



Reduce Total Overhead by Itself

- A 25% reduction in Total Overhead is required for the \$30 million benefit
- How do we cut overhead spending? Incremental gains are not enough.



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Which Is More Attainable?

- 120% Increase in Revenue

OR

- 0.75% Reduction in Project Costs

OR

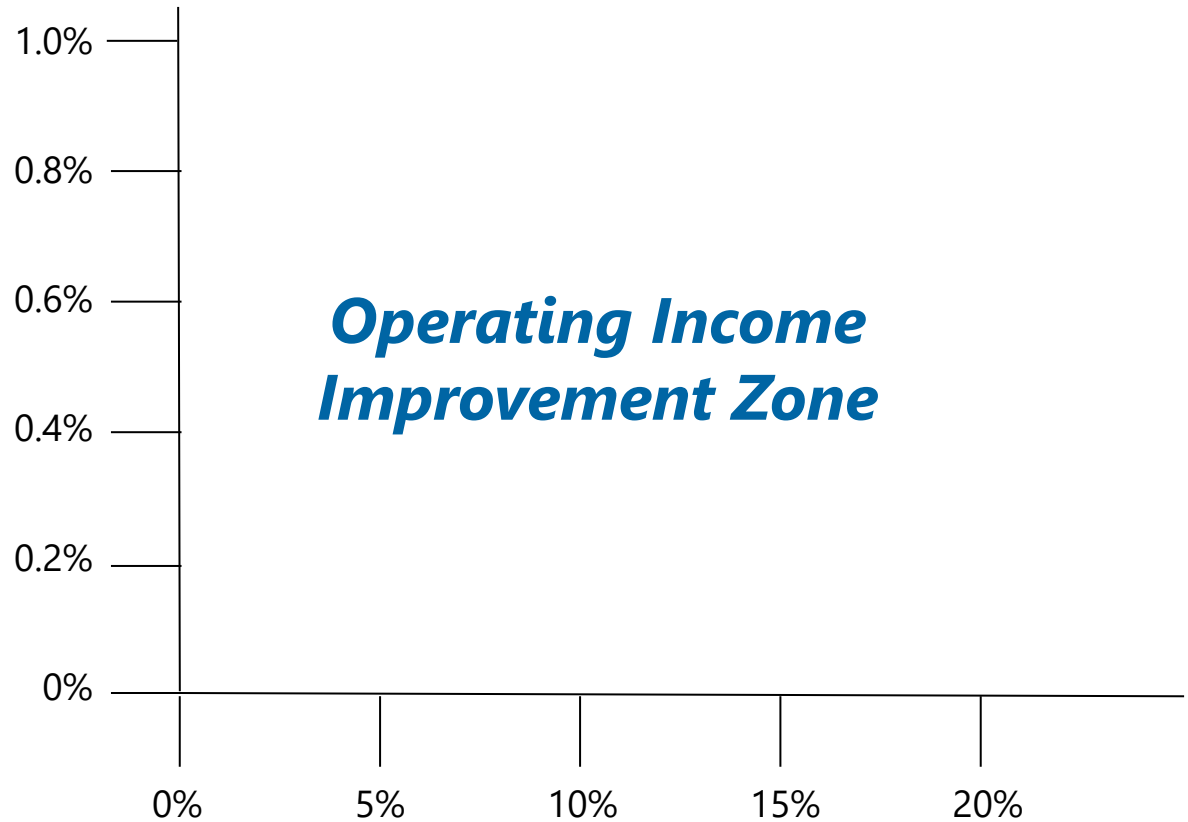
- 25% Cut in Overhead Spending

*Let's not think "either/or" and
look at combinations of moves.*

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Introducing the **Financial Improvement Contour Map** – The Axes Are % Improvements for Given Line Items

**Percent
Reduction in
Project Cost**

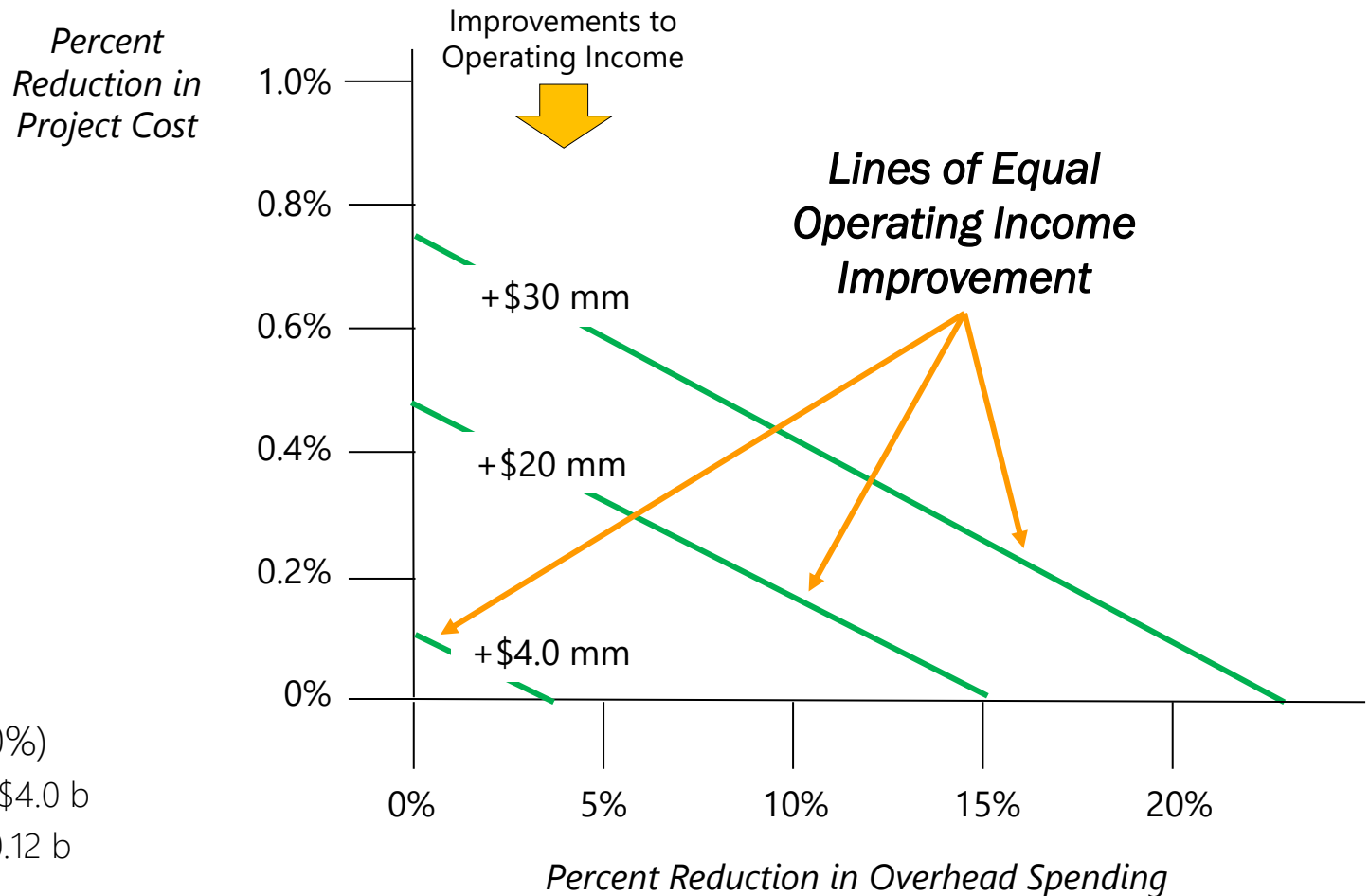


- ➔ Baseline (0%, 0%)
 - Project Cost \$4.0 b
 - Overhead \$0.12 b

Percent Reduction in Overhead Spending

Contour Map:

Draw **Lines of Equal Improvement to Operating Income**
(Fortunately, We Have a Linear Financial Model)

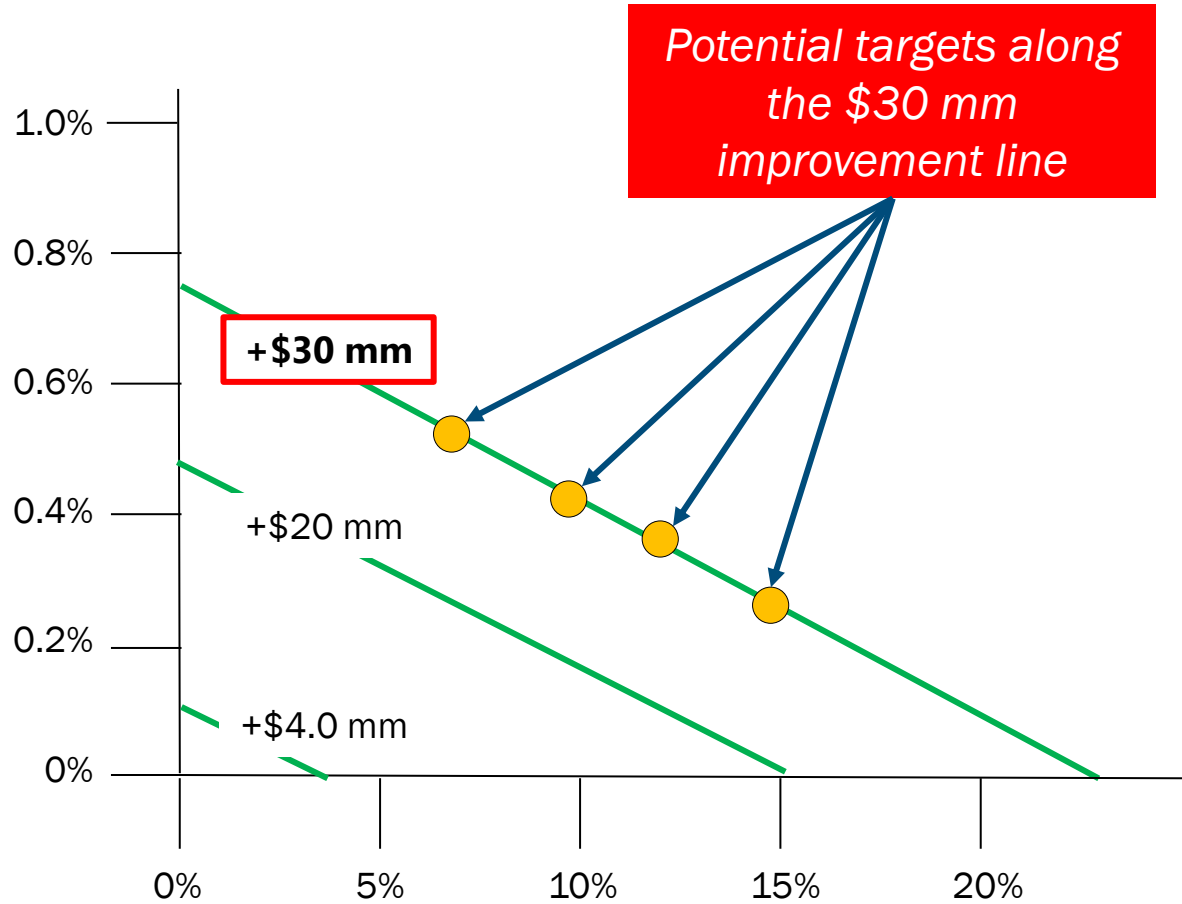


- ➔ Baseline (0%, 0%)
 - Project Cost \$4.0 b
 - Overhead \$0.12 b

Targeting: Pick a Destination on the \$30 million Improvement Line

Targeting is a strategic decision to be made by senior management.

Percent Reduction in Project Cost



➔ Baseline (0%, 0%)

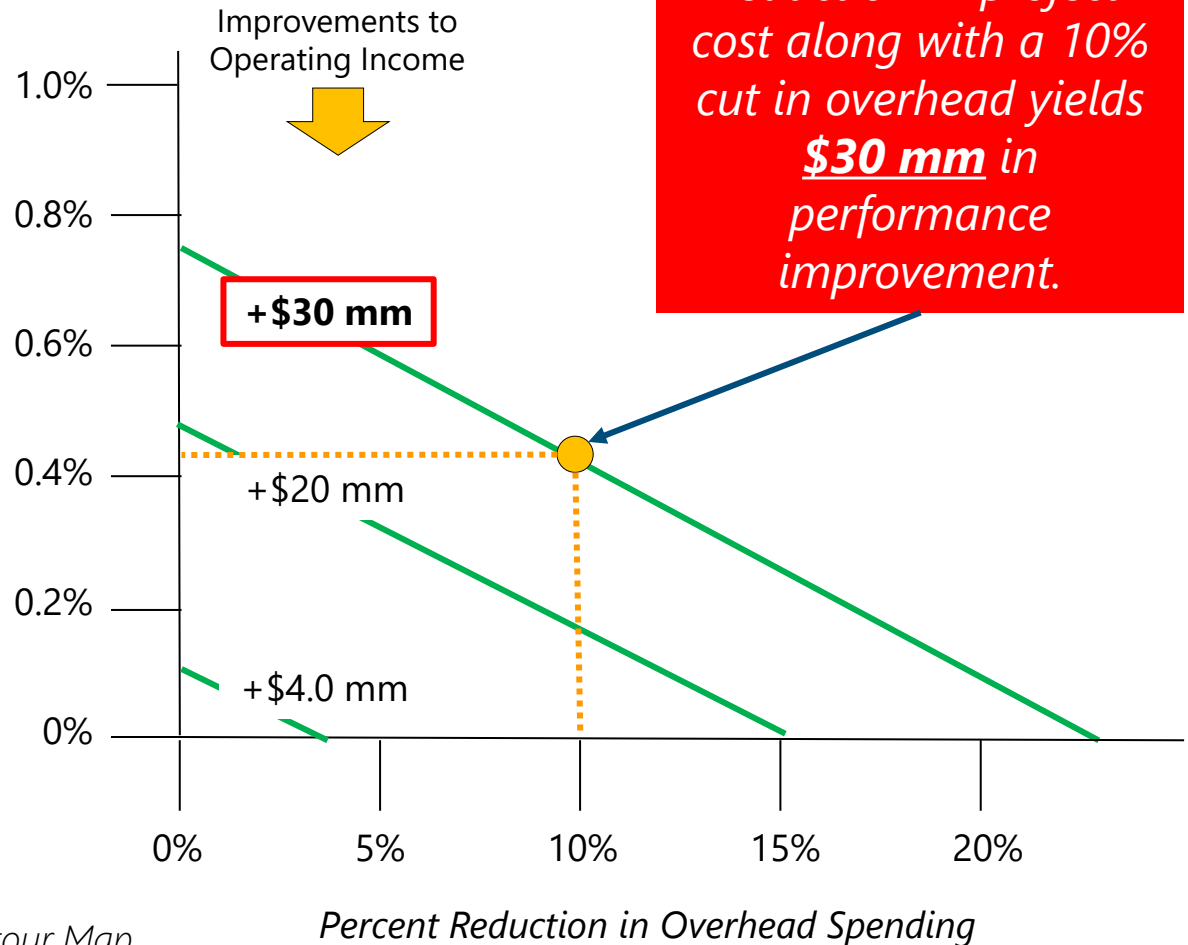
- Project Cost \$4.0 b
- Overhead \$0.12 b

● Targeted Improvement on the Contour Map

Percent Reduction in Overhead Spending

Combining Reductions in Project Cost and Overhead Puts a \$30 Million Improvement within Reach as Shown

Percent Reduction in Project Cost



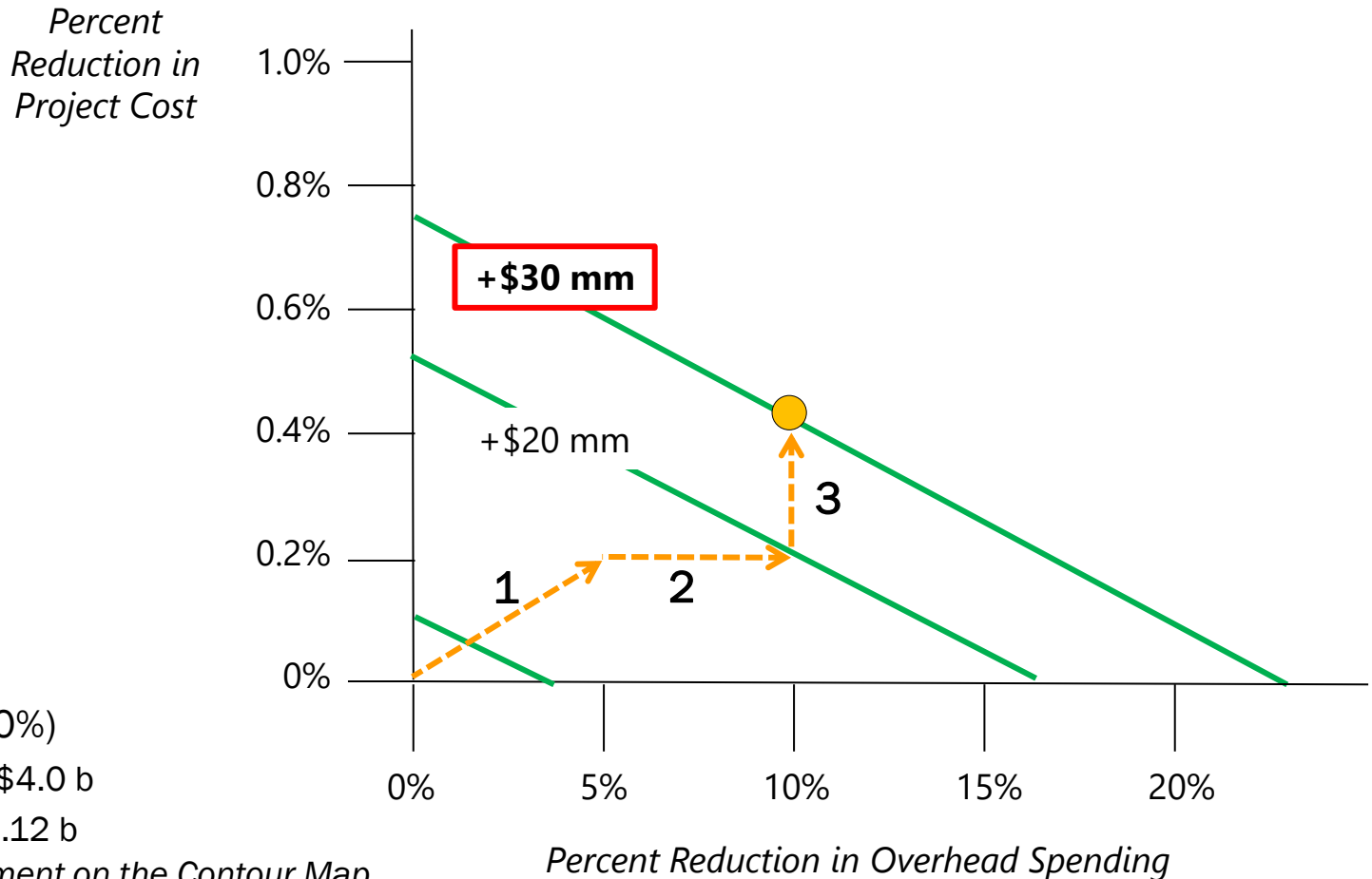
➔ Baseline (0%, 0%)

- Project Cost \$4.0 b
- Overhead \$0.12 b

● Targeted Improvement on the Contour Map

Create a Performance Improvement Roadmap

-----> Example Pathway Shown: (1) 0.2% cut in project costs & 5% cut in OH; (2) additional 5% cut in OH; (3) additional .25% cut in PC



Reducing Project Costs

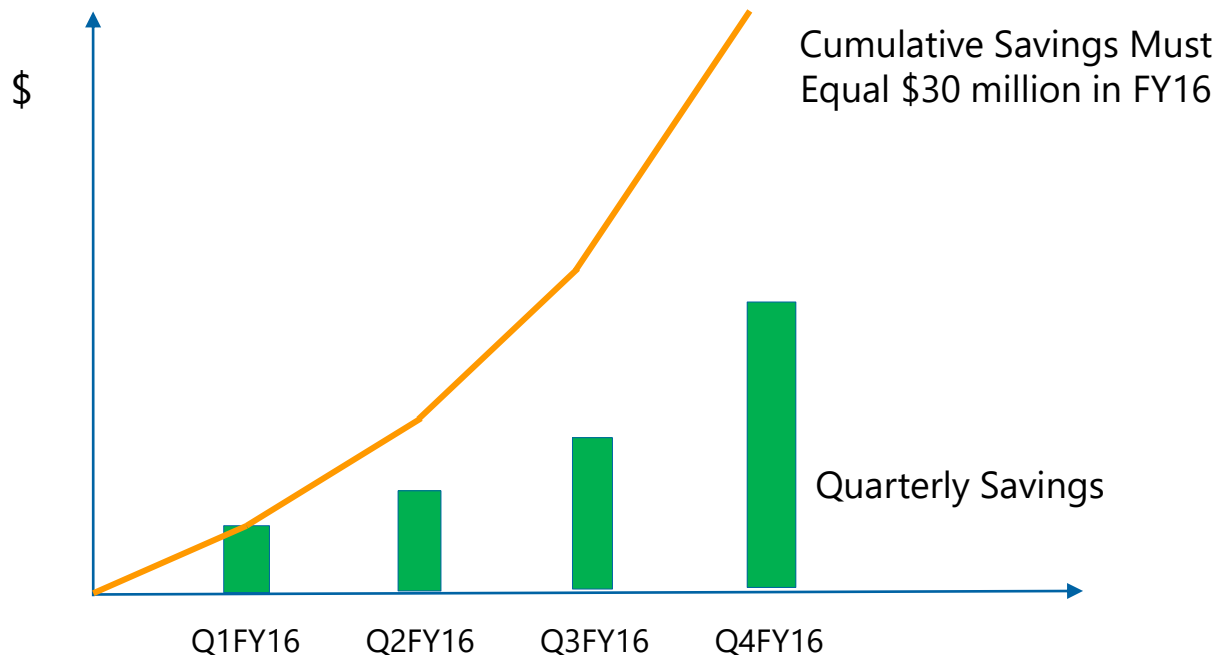
- Project Cost reduction requires a laser focus
- Decompose Project Cost into controllable and non-controllable components
 - General conditions, materials, labor, self-perform versus contracted, etc.
- Develop a plan-of-attack for each controllable component
- Implement a Strategic Procurement Initiative
- Implement an Operational Excellence Program
- Determine timing and forecast the FY16 benefit to Operating Income

Reduce Overhead Spending

- Required Overhead spending cuts cannot be achieved incrementally
- Develop functional spend reduction strategies, for example:
 - Sales: sales force productivity maximization (\$ sales/person)
 - Marketing: effectiveness optimization
 - IT: new service level agreements, outsourcing and shared services
 - Finance: standardization, centralization, consolidation into shared services, Business Process Outsourcing
 - Human Resources: standardization, centralization, consolidation into shared services, Business Process Outsourcing
 - Facilities: consolidate service contracts and leverage buying power
 - Other...
- Determine timing and forecast the FY16 benefit to Operating Income

Avoid the Trap of Too Little, Too Late

- Start now to provide enough time to significantly impact FY16 operating income



Next Steps

- Strategic decision-making: how far and how fast
- Determine timing of financial performance improvement initiatives
- Determine if that is adequate to capture an additional cumulative \$30 million in operating income by the end of FY16
- Calculate investment in implementation resources (internal and external)
- Develop Performance Improvement Roadmap
- Gain owner, executive, and management alignment

AN AFTERWORD

The Results

- Acme leadership fell short of the \$60 million operating income requirement by approximately \$5 million
- No one on the leadership team was involuntarily terminated
- Private equity owners set a higher bar for FY17 given what Acme executives demonstrated in FY16

So What?

- Contour Maps show the major line items comprising the profitability metric for your firm (e.g., operating income, EBITDA, etc.)
- Not all financial levers equally impact profitability
- The most feasible and expeditious moves create a profit improvement roadmap (pathways)
- Multiple paths can be taken to reach a given point on the map
- Improvement progress can be plotted on the Contour Map
- The Contour Map approach works for multiple industries in both the manufacturing and service sectors

Questions?

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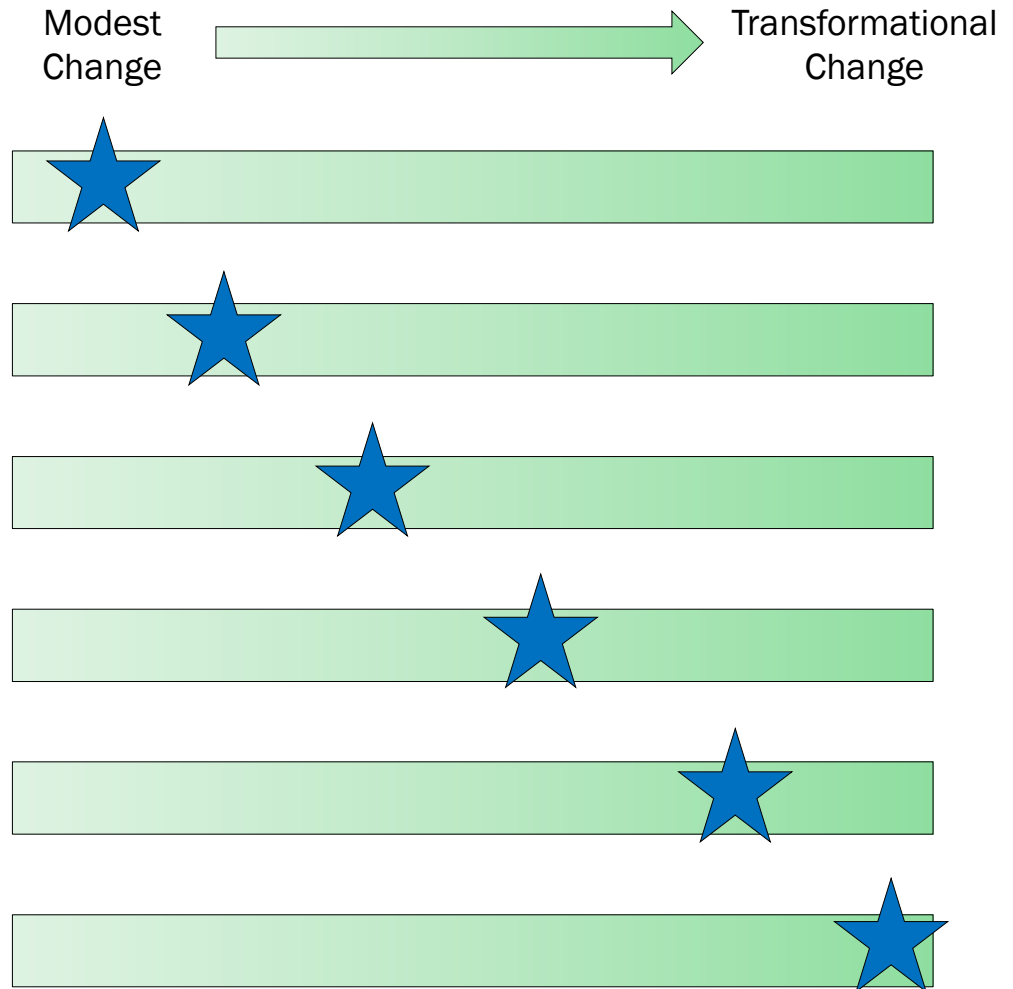
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APPENDIX

In General, How to Reduce Overhead

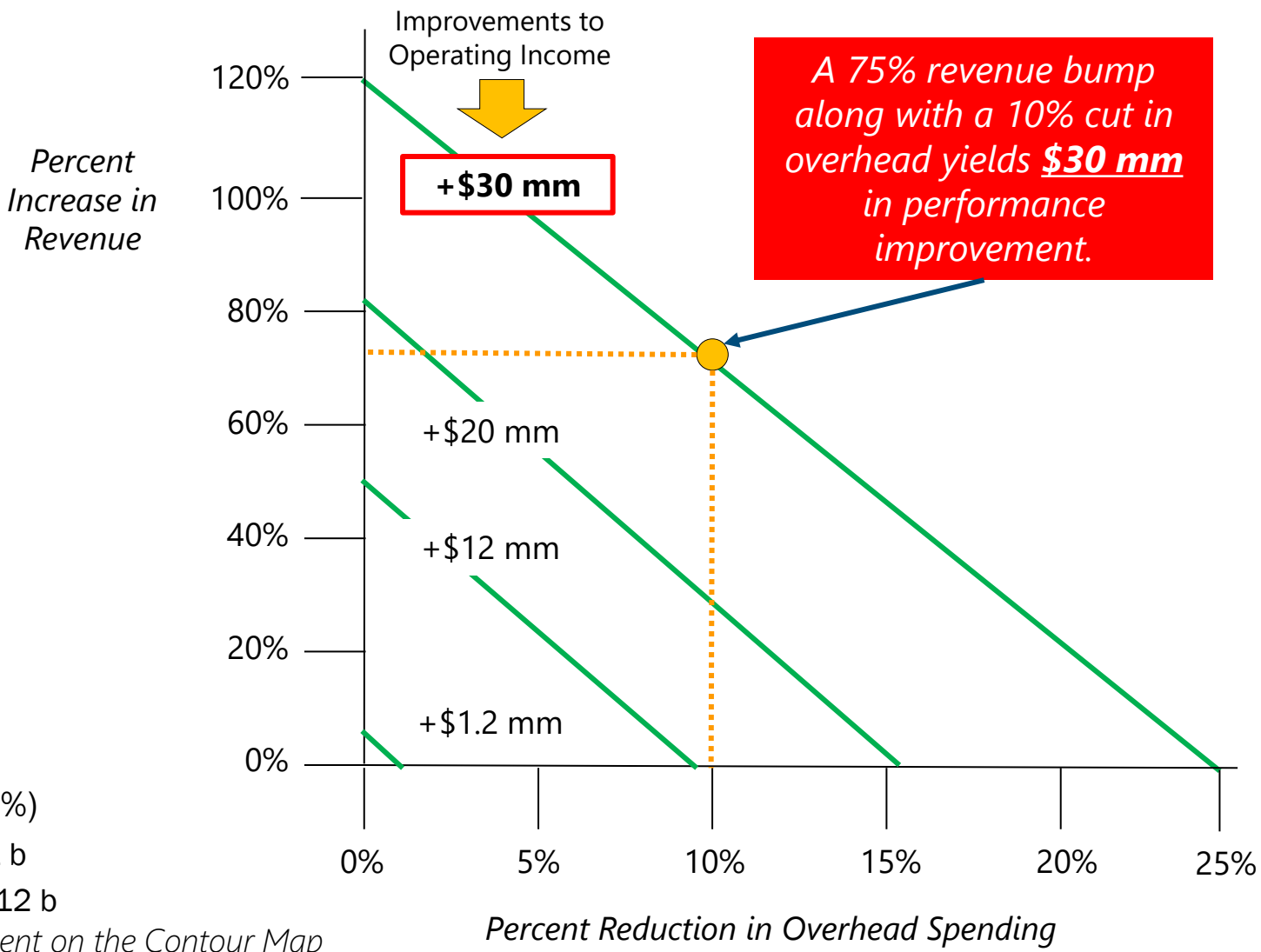
Options

- Headcount reduction
- Work elimination
- Process & IT reengineering
- Shared services model
- Business process outsourcing
- Remove business unit structure



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Pursuing \$30 million by Combining Revenue and Overhead Is Unrealistic



- Baseline (0%, 0%)
 - Revenue \$4.1 b
 - Overhead \$0.12 b
- Targeted Improvement on the Contour Map