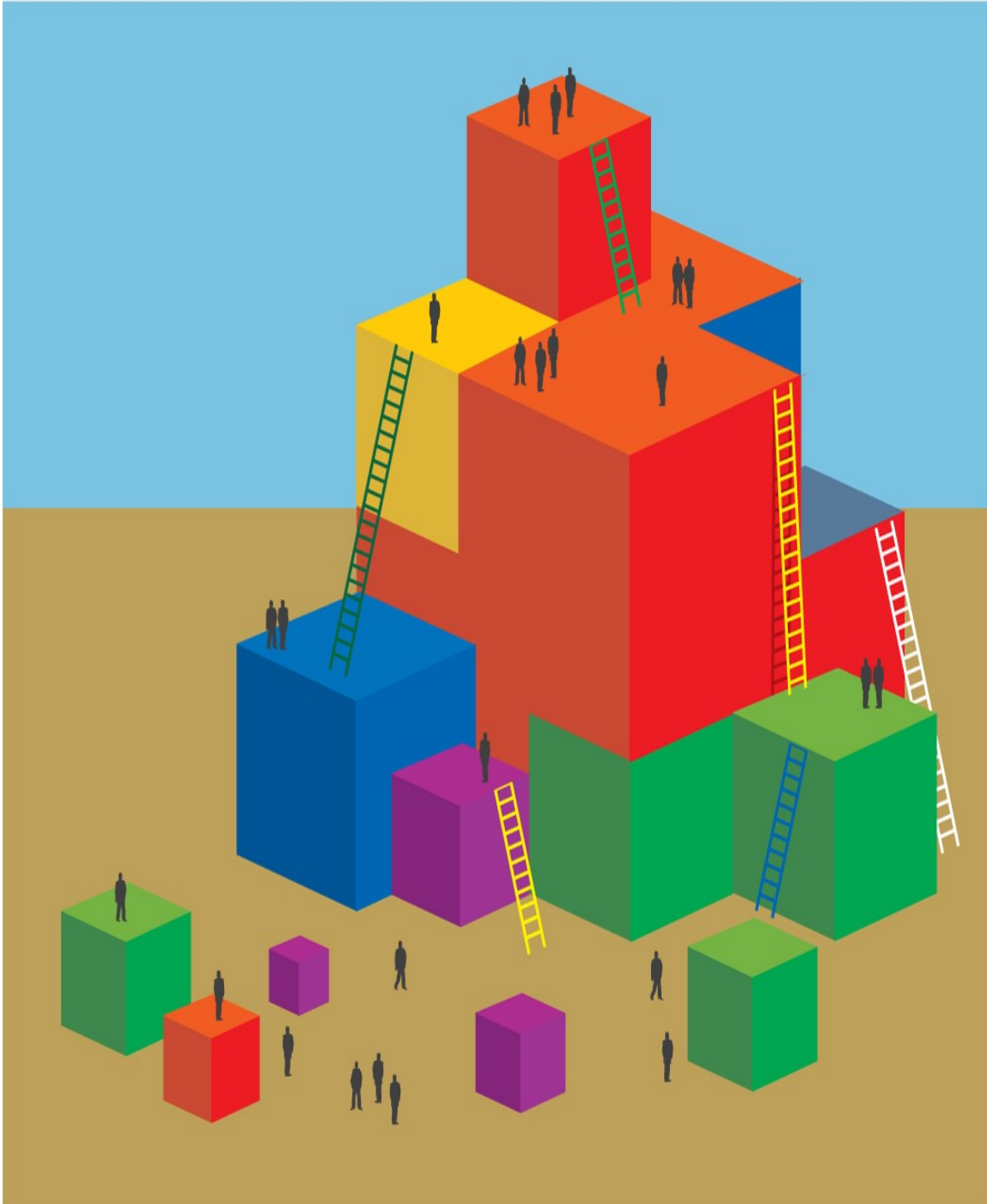


Capitalism From Within



Capitalism from within is a culture of explicitly developing strategies, making decisions and assessing performance inside the company aimed at boosting efficiency, growth and sustainability over time. It is the internalization of capitalist principles by embracing the economic model as the path to greatest success.

As unemployment continues to rise (now at 9.8%) and the economy continues to nosedive, our televisions and newspapers (those that remain) are filled with pundits and politicians blaming business and profit takers for our economic pain. They are, in effect, blaming our economic system of capitalism for the current state of society and this 20 month long recession. While this debate may sell newspapers and enhance television ratings, the small business owners in this country know that capitalism is the driving force behind growth, efficiency and innovation. Now, more than ever before, small business needs to ring the bell for capitalism.

Entrepreneurs and their investors offer their skill and capital with the hopes of building a business that over time will be worth more than the value of the original investment of time and money. The time and talent of the entrepreneur and capital offered by investors is expected to yield adequate returns for both their risk and opportunity costs.

Most of us benefit as stakeholders in one form or another. Whether we invest our personal funds or liquidate our retirement funds, we want to see higher returns for our investment. However, small business is a merciless treadmill. Every owner faces this cruel taskmaster regularly but many protect their managers rather than relay the downward reality.

Capitalism working internally unprotects the various business units operative within a company and pressures the company as a whole, to demand better performance and efficiencies.

The spirit of capitalism operating internally should steer strategies, decisions and performance measures. The various departments maximize cash flow by operating efficiently while making investments in people and capital equipment that promise a better than adequate return in the near or long term.

For the value decision framework to be effective, owners must embrace the notion that creating value is the prime objective and practice capitalism practiced internally. This leads to an owner-like frame of mind where employees treat the company's resources as if they were their own.

The best indicator of economic effectiveness is the creation of wealth for shareholders. Maximizing shareholder return is the mission of small and mid-sized businesses. Small business owners are very interested in their

stakeholders as well. If their business does not satisfy its customers, prices and volumes suffer and so do shareholders. If employees are not satisfied, they will seek opportunities elsewhere and this too harms shareholders. And if suppliers are squeezed too hard, they go to competitors and shareholder value again declines.

It is true that in the short term a business can jack up profits by squeezing employees, customers or suppliers, but these tactics head to declining quality, shrinking volumes and a loss of long term value that more than offsets the benefits. Over time, the best indicator of the balanced delivery of stakeholder benefits is the true economic result for shareholders.

Capitalism from within operates at all levels in a company. Owners should develop every business strategy, implement every operating plan and make every decision with the ambition of building a broad, pervasive culture of ownership. This seems simple yet can be harder than it appears. Even inefficient businesses with less desirable products or services often earn a decent return in good economic times. It is hard to improve or part with inefficient performers after the tide goes out. But as boom-times recede, weak companies become casualties.

Many owners knew their business had serious problems even when times were good but they did little about it. They were fixated on their growth and put efficient operations on the back burner. Now we have the opposite problem. Far less effort is focused on developing growth plans . . . owners are consumed on fixing their operational problems. At the bottom of the business cycle most small businesses miss the opportunity to invest in growth plans because all their attention and resources are diverted.

How does this happen? Most small business owners embrace the belief of maximizing shareholder investment and use a measure of return or economic profit and emphasize efficiency over growth. Keeping the balance of growth and efficiency in place throughout the business cycle requires strategic planning initiatives, profit and expense controls and performance incentives that drive the owner's desired culture.

Internal Capitalism is an Ownership Culture

Many small and mid-size firms benefit from being relatively decentralized. Although authority for major decisions is held by the owner, the various departments or decisions are encouraged to develop their own strategies and plans for implementation. When considerable authority exists at the department/division level, several advantages are possible.

- A. Focus: Decentralization of various business units allows for the consideration of core competencies and allows those units to focus on *their* issues without being distracted by the issues of other units.
- B. Creativity: Long term success always involves innovation in terms of product development, marketing enhancement, etc. The creativity and “out of the box’ thinking required to deliver innovations tends to be squelched in larger groups that resort to peer pressure to resist change. Many good ideas have been killed by creators unwilling to stand up when out numbered by naysayers chanting “that’s not the way we do things here.” Separate business units tend to be more creative.
- C. Clarity: Individual departments and divisions tend to break down the harmful cross subsidies that conceal persistent inefficiencies. Owners subsidize weaker business units by “throwing good money after bad.”

This is not to say we should never subsidize a new business unit or a weak one. Indeed, the strength of the whole is the ability to commit resources to sound long term ideas. To make this decentralization of decision making work, the business unit heads must have an owner-like mentality and must be provided with the training and the tools to properly evaluate strategic and tactical decisions. With decentralized authority must come decentralized accountability via incentives that mimic owner-like risks and rewards.

Commitment and Implementation: a Four Step Process

1. Have your company evaluated and analyzed by a competent, independent third-party; department by department, division by division, business unit by business unit.
2. Once analyzed, refine your business. Have resources been supplied to business units that create value and withdrawn from those that do not? Evaluate the past, present and future expected growth and efficiency of each business unit.
3. Align strategies with owner expectations. Value is created when resources are “put to work” earning acceptable returns and when assets are sold for more than they are worth internally. Planning needs to directly address growth, differentiation and efficiency. Look for underserved gaps and identify potential new strategic initiatives that broaden/deepen market penetration, improve profitability or otherwise materially boost financial performance. Then prioritize and select initiatives based on growth, differentiation and efficiency. The strategic plan establishes a “business case” for each initiative and a roadmap for achievement.

4. Instill discipline in the various management processes. To reinforce the strategy, processes must be aligned with owner's expectations. The very same measures used to develop the strategy need to be the focus of the budgets and scorecards to ensure accountability for execution.

To motivate owner-like behavior requires incentives based on performance measurements of growth and efficiency at the appropriate level of the company. By taking these prescribed steps to embed internal capitalism, owners will have the tools and frameworks to deliver the performance demanded and expected.

Need help? Give me a call and let's talk about it.

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