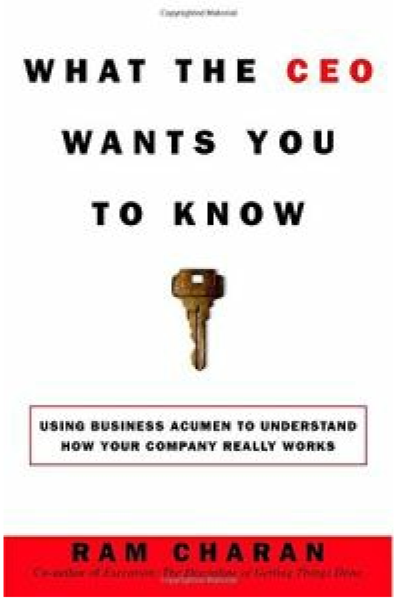

Book What The CEO Wants You to Know

Using Your Business Acumen to Understand How Your Company Really Works

Ram Charan
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Recommendation

An expert can deconstruct a business down to its basic driving forces to diagnose how it is working. Now, you can do the same – with this concise guide from author Ram Charan, who refers to the ability to work with operational essentials as “business acumen.” He bases his initial ideas on his family’s shoe business in India. This family-owned business fought hard for every sale, and each night the relatives discussed what had happened during the day, which goods customers bought and what the store’s competitors were doing. When he left home to study and, eventually, to become an author and consultant to global companies, Charan remembered those hardscrabble lessons. Here, he distills the core similarities between street vendors and global corporations in what amounts to a narrated business dictionary. This book's clear explanations of essential concepts will help you more deeply understand the vocabulary and ideas at the heart of business.

Take-Aways

- Develop your “business acumen” by learning the essential forces that drive business.
- The core of any business consists of customers, “cash generation, return on assets and growth.”
- To prosper, your company must grow. Be sure it grows wisely.
- Expanding sales must be accompanied by increases in other critical financial metrics. Otherwise, growth can cause bankruptcy.

- Accompany growth with solid cash flow, steady speed and sensible margins.
- Set no more than five clear priorities so the organization can focus.
- Everyone from the sales force to the mailroom should understand cash flow.
- Know your customers firsthand; don't rely on polls and surveys.
- Seek employees who fit your culture and enable them to execute. Provide practical coaching and useful, specific feedback.
- See the total picture. Understand all the forces at play and how they interrelate.

Summary

A Comprehensive Understanding of the Fundamentals

When top CEOs distill their businesses down to the clear fundamentals, and then find a way to convey those core ideas to their managers and employees, everyone benefits. People get a better idea of what their jobs are all about and why they matter. The company's "top line" (sales), as well as its "bottom line" (profits) improve. People gain the opportunity to grow while the company benefits. Smart CEOs have learned that the same basic factors apply to any business, regardless of its size or location.

> "The best CEOs use their business acumen to reduce complexity, whether internal or external to the company, to the basics of money making."

Leaders who really know these basics completely understand how a business makes money. They have "business acumen." The next meaningful step for them is to "make sure that everyone in the company understands these fundamentals," because having a workforce that understand how business functions helps the company succeed.

The Insights of Acumen

When author Ram Charan was growing up in rural India, his father owned a small shoe shop. Although Charan's father had no formal training, he built a solid reputation in a competitive environment and earned enough money to educate his son. Charan's nephews still run the shop. When people run their own businesses, they make many decisions without the benefit of sophisticated analysis. When Charan was a child, his family would gather each night after work. They would sit on the rooftop of their home, away from the heat, to discuss what had occurred at their shop that day. They talked about who came in and who did not, who received credit and what the best shops in town were doing. The shoe business was based on relationships. The family's biggest competitor ran the shop next door. He often tried to convince customers to return the shoes they had purchased from the Charans and buy them from him instead.

> "When it comes to running a business successfully, the street vendor and the CEOs of some of the world's largest and most successful companies talk and think very much alike."

Charan eventually left home and earned an engineering degree. He took a job with a gas company in Australia. The firm's CEO recognized Charan's business talent and encouraged him to apply to the Harvard Business School. After earning his doctorate, Charan became a consultant. He saw his task as breaking corporations down to their basic parts and helping the parts work together. He used this experience to develop the concept of business acumen. He notes, "I saw that regardless of the size or type of business, a good CEO had a way of bringing the most complex business down to…the same fundamentals I learned in the family shoe shop."

Universal Factors

The basic concepts of any profit-making venture, from the street vendor's stand to a major corporation, make up the "fundamental language of business." They are: inventory, sales forecasting, cash flow, merchandising, product mix, return on sales or operating margin, return on assets, customer focus, best practices and creating shareholder value. The core factors which determine the health of any business are customers, “cash generation, return on assets and growth.”

> “Many successful CEOs have had experiences early in their lives similar to that of a street vendor, giving root to their business thinking.”

When people take corporate jobs, they tend to start within departments that fulfill specific functions (i.e. accounting, logistics and finance). They generally continue to work within vertically integrated departments, called “silos.” This narrows their perspectives, so they get distorted views of how the overall company operates. People become good at what they do, but they do not necessarily become good overall business people. Enable your employees to see your business in its totality. When they understand its workings beyond their silos, their performance and outlook will improve.

Most businesspeople, in large companies or small ones, have an overall business sense. For instance, a fruit seller with a street stand lacks a formal business education, but he still makes daily sales forecasts to know how much merchandise to buy. He sets a competitive market-based price, which he may change as the day progresses so he can move his inventory. He manages his cash flow so he can continue to operate, and he merchandises his goods by putting his most attractive mangoes at the front of his stand.

“The Building Blocks of Money Making”

The process of earning money has three segments: cash generation, return on assets (a combination of margin and velocity) and growth rate. Cash generation is the difference between the amount of cash that flows into a business and the amount that goes out. In small companies, cash and income are the same, but in companies that let customers buy on credit, the availability of credit creates an accounts receivable unit. Companies that owe money to suppliers thus also carry accounts payable. The gap between receiving money and spending it defines cash flow.

> “Customers need a simple reason to buy from you.”

When problems arise, corporations can run out of cash. This happened to Chrysler in the early-1980s and to Volkswagen in the late-1980s. The ability to generate cash determines the health of a business.

People in sales, in inventory management and even in the mailroom should understand cash flow. When salespeople ask customers to pay in 30 days as opposed to 45 days, the salespeople are helping their company, since it gets the cash faster and can use it to meet its needs.

Improved inventory management also can dramatically help cash flow. In its early days, Amazon had no inventory, so when customers bought a book online and paid with a credit card, Amazon could use their cash. During this period, that is how Amazon paid for its marketing.

Businesses use their investment capital to buy assets, whether they are tangible, such as inventory, facilities and equipment, or intangible, such as investments. Business owners should know how much they earn. They should understand return on assets (ROA), return on investments (ROI) and return on equity (ROE).

> “What your CEO wants you to know is how these fundamentals work in your company.”

To get good investment returns, you need to achieve your profit percentage quickly. This is the concept of velocity or turnover rate, the speed at which goods move from production to customers. High velocity means a greater return. The best-managed companies have “a return on assets greater than 10% after taxes.” That requires a CEO with excellent business acumen and a sharply honed sense of what makes a business successful.

Businesses with any fixed assets (such as telecommunications or auto companies) have to work to accelerate their velocity. Dell Computer assembles computers from other vendors’ parts. Its return on invested capital is extraordinarily high even though it is not a manufacturer and it does not have a high profit margin. However, it is good at selling and assembling computers - Dell can make a customized computer in a week - and that drives its velocity.

Growth and Success

Many organizations focus on growth, but fail to factor in the need for velocity. Unplanned growth can even lead to bankruptcy, unless expanding sales are accompanied by increases in other critical areas, such as production and delivery capacity. However, growth is a primary measure of success. When a company does not grow, everyone suffers. Westinghouse failed to grow when it had to compete with GE. The Digital Equipment Corporation (DEC), which made mid-sized computers, stopped growing when the industry shifted to PCs.

> "Direct contact provides insight other kinds of market research cannot."

To grow, companies must be customer savvy. Sam Walton, the late founder and CEO of Wal-Mart, regularly visited stores and spoke with customers. Bob Nardelli, CEO of Home Depot, worked alongside his employees and waited on customers. Jac Nasser, CEO of Ford, spent time with customers. He visited places where young people congregate so he could stay abreast of their taste in fashion. When Ford's Lincoln Mercury division was losing market share in the lucrative luxury car market, Nasser moved the division to California so its managers could stay in closer touch with their market's rich, trend-setting consumers.

The alternative to staying informed is painful. Sears lost touch with its customers in the late-1980s and early-1990s, when women began shopping at discount stores. Sears had not updated its styles and it missed this shift in customers' habits. In the mid-1990s, a new Sears CEO brought in famous clothing labels, paid attention to customers, renovated the women's departments and increased operating income, earning a solid boost in market share.

The Big Pictures

Top CEOs understand how all the elements of business acumen work together, much like doctors weighing symptoms and medical test results in the light of their own judgment and experience to arrive at their diagnoses. Such CEOs use their business acumen to make things simpler. They "reduce complexity" so they can clarify their decision making, test their logic and set forth defined limited priorities. CEOs should choose "three or four business priorities (no more than five)" to keep customers and make money. For example, during his first year at Ford, Nasser set reducing costs and capital investment as his priorities. He refocused on customers and e-commerce after dealing with those two initial priorities.

> "Growth for its own sake doesn't do any good."

Jack Welch understood the relationship between employee productivity and margins, and how they generated cash flow. He kept a keen eye on the interactions among different business pressures. For example, he re-evaluated GE's aerospace divisions in 1989 when the Cold War ended and the government reduced the U.S. Defense Department budget. Welch reacted by selling GE's defense division to Martin Marietta for a combination of cash and stock. Martin Marietta benefited when it merged with Lockheed, and GE benefited from its equity exposure in the new company when it sold the stock and generated a large gain for its shareholders.

Well-run corporations create wealth. In the "real world of companies," investors measure wealth creation in stock market terms, particularly a stock's price-earnings (P/E) ratio. A P/E of nine means its stock value is nine times its earnings. An increase in P/E creates shareholder wealth, but the ratio is complex. As it reflects the company's financial past, its expectations and the market's expectations, P/E emerges from a combination of factors.

It's All about People

Modern corporations must focus on execution, not on personality or trendy leadership theories. To execute, companies must rely on their people. CEOs should foster their employees' ability to perform consistently, make good decisions and get results. Walton sought common sense in the people he hired. He trained his managers to handle inventory, sales, pricing and customer service, and gave them wide decision-making authority. Look for drive, talent and the right "mind-set" when you hire. Like Starbucks, seek people who are a good match with your culture and needs.

To enhance performance, provide constructive coaching and honest feedback. Make each person part of a united cohesive group and provide a “social operating mechanism” to “synchronize” their efforts. For example, Walton sent Wal-Mart regional managers to shop in their competitors’ stores for a revealing field survey that delivered “quick market intelligence.” They purchased items, compared prices and examined displays. Then, they brainstormed about their observations with Wal-Mart buyers and marketers.

> “True businesspeople combine the elements of money making to get an intuitive grasp of the total business.”

Even if they run extremely complex corporations, CEOs with business acumen know how to think like street vendors. They have a complete grasp of the key elements that drive their business. They make their businesses easy to explain, so they can focus on making money. They can see the big picture. You, too, can use business acumen to filter out tangled situations, keep everyone informed, set clear objectives and enable your company to deliver consistent results. The ability to “understand your company’s total business” comes from a background of knowledge and experience.

It is what the “CEO wants you to know.”

About the Author

Ram Charan is an adviser to senior executives in companies of all sizes. He is the author of *Boards That Work* and the co-author of *Every Business is a Growth Business and E-Board Strategies*. He has written for the *Harvard Business Review* and other publications, and he taught at Harvard and Northwestern.