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Musings

#19: Managing Forward April 10, 2020

Go to <https://gilesrichard.com> for past musings. We have created a “Musings in Return” section for you to see thoughts of other recipients. I am also putting a “second thoughts” section after my initials with some follow-up thoughts on previous musings.

Good leaders are always looking over the horizon. They are the captain of the ship ensuring no icebergs ahead.

I am frustrated when I read about organizations surprised by developments in the market that creates an existential threat. I am not talking about a Black Swan event like the current Covid-19 situation. I am talking about any retailer who in 2020 does not have meaningful online capabilities. Amazon became a public company in 1997!

The leader’s job is to manage forward and predict what is going to happen in the market and with employees. The job is to take preemptive action to mitigate risks. One way to do this is to constantly seek inputs from competitors, customers and other constituents. Asking questions and listening (see Musing #16: The Importance of Listening).

To have something bad happen in business. To be surprised by it is inexcusable.

You need to establish KPIs (key performance indicators) which provide you with visibility. The better the KPIs, the more time you have to react. Like your car’s headlights on high beam. Sales create the revenue which then covers the expenses. However, good management should be able to forecast sales. Especially in today’s digital world, you should be able to measure traffic on your website or volumes of calls. Then you should have the statistic models on how those potential buyers convert in various steps through the funnel. While every specific buyer is unique, when you aggregate them up, the demand should behave in statistically consistent ways. Make your sales leader give you a projection not just the budgeted number.

Think about how the healthcare system has been preparing for Covid-19. They have models on the rate of infection and what percentage will need hospitalization. They know how many days from test result to needing a ventilator so they can take the testing results today and figure out the ventilators needed in a week.

One unfortunate model is the correlation of third grade reading level and adult incarceration. Some states using their third grade reading tests to figure out how many prison beds they will need in 10 years. That is managing forward in a sad way.

In a business, your CFO needs to be your partner in this endeavor. I am not a fan of the basic annual budgeting cycle where a budget is set and a year later, wash and repeat. Rather, executives need a

rolling four quarter forward projection. As you finish a quarter, you add another one on the other end. This should be a complete three statement model: income statement, balance sheet, *and cash flows*.

One common mistake people make is to do annual budgets and miss the “run rate” they have going into next year. You need to know the full year amount of the expense structure you have built up by either taking the fourth quarter x 4 or December x 12. When you add an expense midyear, it only hits your P&L for a part of the year and you can miss the annualization of the impact.

The Covid-19 crisis has made managing forward difficult. There are so many unknowns. Don’t let that stop you from projecting! Rather, project ranges rather than specific numbers as volatility has increased and create scenarios under different assumptions.

The best leaders I know right now are discussing the equilibrium of reversion (thanks Jamie Cowie for the term). Things will not go back to where they were before Covid. The world will be more digital now – more telehealth, more online education, more remote work. The question is how much reversion will there be? How far back to the pre-Covid world will we go?

The best leaders are also contingency planning. What if we are still dealing with latent Covid issues in the fall? Right now, consumers have accepted subpar quality of online delivery because it was rushed out in a crisis. The consumer won’t be as forgiving in the fall. Good leaders will invest in their digital capability now so if they have to use it in the fall, they are ready. They are managing forward. No Leo and Kate on the bow of their ship.

Be safe.

Jml

Second Thoughts:

I failed to mention institutional equity investors in my Partners musing. Don’t just take the highest valuation when raising money. Really assess if the investors are someone you can be in the foxhole with. You might want to take more dilution for a better partner as you will probably make more money on the second transaction.