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Excerpts from *Bottom-Line*
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Bottom-Line Management

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Chapter One. **Bottom Line Management: An Introduction**

Why you should read this book

You're reading this book because you want to do good and you want to do well in your organization. In this book, I will help you do both.

I will help you if you are (or aim to be) a senior manager in an organization and have a seat at the table where key decisions are made. I will also help you if you are (or aim to be) one of the valued employees doing the good work of the organization in your individual office, cubicle, laboratory, or sales territory.

What makes you valuable to your organization? You're valuable if the organization would lose out if it *weren't* paying you for your input. The head of the organization would have significantly more to do if you weren't there. Without you, less would be produced. In your absence, poorer decisions would be made.

But in order for you to be valuable, your input must *truly* be valuable. Your input cannot be valuable if you do not know what the organization is trying to achieve. It cannot be valuable if you do not know what strategy the head of the organization and the other leaders have adopted to try to achieve it. And it cannot be valuable if you cannot contribute to the making of good, sound, purposeful decisions.

Those are the things that this book will help you do: understand the organization's bottom line and help you contribute to it.

Helping the person in charge improve the bottom line

All organizations have a person, or occasionally a small number of persons, who are in charge. These leaders are accountable for the success of the organization. These leaders are the people who have the ultimate responsibility for managing the people in the organization. And these leaders are the people for whom you work, directly or indirectly.

In most companies, the leader is the CEO. For sports teams, the leader is the head coach (football, basketball) or manager (baseball). For a university, the leader is the president. In other not-for-profits, the president may be called director-general, secretary-general, or executive director, but he or she is still the leader. The head of a government agency is the secretary (U.S.) or minister (most other countries).

Running a company, a sports team, a university, a not-for-profit, or a government agency is an enormously difficult and time-consuming job. Great responsibility. High stress. Ultimate accountability. A chief executive can make literally billions of dollars worth of difference. No wonder that these people are paid so much when they get it right! (Alas, some of them have arranged to be paid just as much in the event that they get it wrong.)

Heads of organizations need all the help they can get. They would love to be able to delegate major chunks of their responsibilities to others in the confidence that those

responsibilities will be carried out in a way that will help the organization achieve its aims.

Here is the first key. Unless you are the head of the organization, your job is to help the head do his or her job. Because the head's job is to improve the bottom line, your job is to help the head improve the bottom line. You will earn a seat at the table when and only when your input is helpful. If it's not, the best thing that can happen to you is that you will be ignored and be left to quietly go about your business in organizational obscurity. At worst, the organization will decide that it doesn't need you and you'll be let go. Aim to be part of the solution, not part of the problem.

Make no mistake about it: any manager who is managing well will hold you accountable for helping him or her achieve the central objective of the organization. You're not simply putting in the hours or trying for results. You have to achieve them.

To do that you must be absolutely, 100%, unambiguously clear on what the bottom-line objective of the organization is.

What the bottom line is

Most organizations have an overriding objective – what in this book I am calling the bottom line. For a company, the bottom line is literally the bottom line of a profit and loss statement. For a sports team, it's winning the championship (I think, but see Chapter Three). For a labor union, it's improving the wages and working conditions of its members. For a research university, it's outstanding teaching and research. For a not-for-profit, it may be something like “a world free of poverty” (the World Bank) or “improve the lives of vulnerable people by mobilizing the power of humanity” (the Red Cross).

Organizations pursue such bottom-line objectives in ways consistent with their own cultures and codes of conduct subject to constraints imposed by competition in the marketplace. Everyone in the organization needs to know what it means to do things “our way,” be it through acting with high integrity, maintaining academic freedom, assuming personal accountability, or delivering a great customer experience.

The head of the organization has ultimate responsibility for increasing the bottom-line objective(s) to the maximum extent possible in ways consistent with the organization's culture and codes of conduct. In a well-aligned organization (and believe me, many organizations are *not* well-aligned), the head is held accountable for the organization's bottom line and is judged accordingly.

For you to be able to help the head of the organization achieve that bottom line, you must know with certainty what the organization's bottom line is. This is more difficult than it seems.

Organizations are often shockingly unsuccessful at communicating to their employees what their bottom-line objectives are. How can you possibly help your organization do better if you are not 100% clear about what “doing better” means in your workplace?

Here's a simple test you can perform for yourself. Write down in one sentence the bottom-line objective or objectives of your organization. Are you having trouble? Now ask a colleague to do the same thing. How close are your answers? In a well-led organization headed by a bottom line president, your answers should be identical or very nearly so.

The first part of this book (Chapters Two through Four) is about what the bottom line is. If you have the good fortune to work for an organization that is crystal-clear about what its bottom line is, you can quickly skim the first part of the book. Most of us are not so lucky. If that's the case for you, you'll have to work at clarity of organizational objectives. Do it – it will reward you many times over.

It's costly *not* to know what the bottom line is

For the most part, employees simply do not understand what their organizations are trying to achieve, or if they do understand, they don't spend enough time on work that helps achieve those objectives. A FranklinCovey study of 11,045 employees in the United States found that only 44 percent said they clearly understand their organizations' most important goals, and only 19 percent have clearly defined job goals. When there are organizational objectives, many employees do not see much of a link between their work and those objectives: only 9 percent believe their work has a strong link to their organizations' top priorities, and just 19 percent feel a strong level of commitment to their organizations' top priorities. Employees say they spend only 49 percent of their time doing work that relates to their organizations' top priorities.

Understanding the organizational bottom line and working towards it makes a huge difference to organizational outcomes. Research in the U.S. corporate sector by the consulting company Watson Wyatt has shown that total returns to shareholders are three times higher at companies where employees understand what the corporate objectives are and the ways in which their jobs contribute to achieving them. A study in the Netherlands by Kees Cools and Mirjam van Praag related total return to shareholders to the number of goals stated in the corporate annual reports and the number of internal targets. After controlling for other influences on shareholder returns, they found that the companies that had just one single target exhibited 9 percent higher returns, other things equal. Imagine being able to do that much better for your shareholders simply by being more focused!

The legendary former Chairman and CEO of Honeywell International, Larry Bossidy, and the famed management consultant Ram Charan put the need for setting clear goals and priorities this way: "Leaders who execute focus on a very few clear priorities that everyone can grasp. . . A leader who says 'I've got ten priorities' doesn't know what he's talking about – he doesn't know himself what the most important things are. You've got to have these few, clearly realistic goals and priorities, which will influence the overall performance of the company." It is this drive to improve the overall performance of the company that separates the Bottom Line Manager from others.

The retired CEO of IBM, Louis V. Gerstner, Jr., got into an illuminating exchange with Associate Editor Ira Sager of *Business Week* on this very issue. Gerstner stated, “I went into IBM believing that its problems were primarily strategy and execution. When I got there, I found out that the direction the company needed to go was pretty clear. This was not a question of picking a direction and saying: ‘Charge!’ You would do that and turn around and nobody was following behind you.” Sager then asked Gerstner, “Why do you believe Wall Street is too preoccupied with revenue growth as the measure of corporate success?” Gerstner replied, “The value that some analysts put on revenue vs. what they put on profit is totally out of whack. If you can grow real cash earnings, that’s 80% of what you ought to do, and the revenue component is 20%. . . I was not going to get distracted because somebody said: ‘Gee, we’d like to see your revenue a little higher this year.’” Gerstner leaves no doubt about which were his two priorities: at Gerstner’s IBM, it was 80% profit and 20% revenue growth. Why not all profit? Because, holding costs constant, revenue growth leads to profit.

Such clear-minded focus is equally important in the non-profit sector. Deloitte and Touche, a global consultancy, wrote this in report to a client: “In a non-profit environment, a corporation’s ‘profit’ is, in essence, the achievement of its mission and vision. Therefore, a non-profit corporation must operate its business in a manner that strives to achieve these goals. When it does not attain the predetermined standards, it clearly is experiencing business issues.”

Another example appeared in a survey article on “The Business of Giving” in *The Economist* magazine. The article stressed the plusses of thinking like a business: be more businesslike, raise productivity, be more strategic, maximize the leverage of the donor’s money. Surprisingly, it also highlighted some negatives about businesses – in the words of management guru Jim Collins, “Most businesses are mediocre.”

A clear-minded focus matters in the government sector too. The U.S. Government Accountability Office, the management arm of the Federal Government, had this to say about a study of a number of government agencies including the Bureau of Land Management, the Veterans Benefits Administration, and the Internal Revenue Service: “GAO found that these agencies are in the early stages of using a set of balanced expectations to appraise senior executive performance and there are significant opportunities to strengthen their efforts as they move forward in holding executives accountable for results. Specifically, more progress is needed in explicitly linking executive expectations for performance to organizational goals.”

It doesn’t matter whether yours is a for-profit or not-for-profit organization. If your organization were run in a more businesslike fashion, you could probably do more of the good work for which your organization exists.

One company’s story

Recently, I worked with a New York City-based professional services company that leads its industry segment. The CEO asked employees to write down how they make the company profitable.

The replies were strikingly uneven. They range from excellent to vague to petty.

The best statements were well-focused. A particularly good response comes from a senior vice president: “I make the company profitable by:

1. Making sure my group understands that ‘success’ must be *quantified* – focus on dollars, percentages, margins (vs. good or bad).
2. Teaching/monitoring/mentoring time management issues to facilitate *smart, efficient* thinking.
3. Articulating and prioritizing *clear* goals and objectives.”

In a well-focused organization, *all* employees would be thinking in such focused, bottom-line ways. Unfortunately for this client, many of the responses were vague and unfocused. A vice president answered that he makes the company profitable by teaching his team to “think strategically.” Does “strategic” mean “purposeful”? What is the purpose? One director said, “I make smart business decisions on behalf of my agency and client.” What makes a decision “smart”? Another director said, “I always try to keep the ‘big picture’ in mind when staffing to keep us as efficient as possible.” What is the “big picture”? A third director said, “I try to maximize each deal that I do.” Maximize what? Those giving these responses have made a good start, because they’re thinking about the business. However, they are not yet focusing directly on the company’s bottom line, namely, profits.

Some of the replies were mistaken, because they brought up the trivial. One manager said, “I save my emails on my computer – instead of printing every e-mail out and adding copy costs and usage to the printers.” Another said, “I reuse paper cups for my tea throughout the day.” Those who answered like this would benefit from the wisdom of the famous bank-robber, Willie Sutton. When Sutton was asked why he robs banks, he answered, “Because that’s where the money is.”

I reported to the CEO my conclusion that many of his people, including some very senior ones, seemed not to understand with absolute clarity where the money is. I told him that if they don’t understand where the money is, they can’t act on it. I relayed my suspicion that many key employees would have difficulty giving a precise definition of “profit,” which would make it very hard for them to be able to work towards higher profits on an hour-by-hour basis. Finally, I recommended that the company improve its profit potential by: i) giving training on the organizational bottom line and business model to everyone in the organization, ii) ingraining a drive for higher profits at every level of the organization, and iii) developing bottom-line decision-making skills for employees at *all* levels of the organization.

Let’s talk more about bottom-line decision-making now.

Bottom-line decision-making

Bottom-line decision-making is the subject of the second part of this book (Chapters Five through Eight). It involves a mix of setting the right objectives, maximizing some things, optimizing others, using sound decision rules, and avoiding unsound ones.

I am an economist, now in my thirty-fifth year as an Ivy League professor teaching students, writing for professionals, consulting for organizations, and advising managers on how to achieve their objectives. I know full well that bottom-line decision-making is difficult to do unless you have been trained to do it. This is where I want to help you.

Bottom-line decision-making has four essential steps. The first step is setting the right objective. As I have already explained, and as the first part of the book develops in detail, setting the right objective is about knowing what the organizational bottom line is and pursuing it incessantly. “Winning decisions” cannot be made unless the organization has made clear to everyone in it what “winning” means.

The second step in bottom-line decision-making is to know when to maximize and when to optimize. “Maximize” means to make something as large as you can. “Optimize” is to achieve the best possible level. My message is straightforward: maximize the bottom line and optimize everything else.

The third step is to estimate fully the most important aspects of the decision you are making. For example, suppose you are considering a new IT system in your organization. What benefits would you expect if the new system is put into place? How valuable are these benefits? What are the costs? Have you included not only the purchase price but also the training and maintenance costs? How sure are you that the total benefits outweigh the total costs? Such decisions involve estimating the net present value of benefits less costs; they are discussed at length in Chapters Four and Seven.

The fourth step in bottom-line decision-making is to use a sound decision rule and avoid unsound ones. Suppose you have to decide which of two or more options will have the greatest impact on the organizational bottom line. What is a sound decision rule? One that produces a demonstrably superior result. What is an unsound decision rule? One that produces a demonstrably inferior result.

Bottom-line decision-making is not easy. In Chapter Five, I will ask you to make a decision about which type of worker to hire. I have tried this exercise on students at my university (Cornell) at all levels - undergraduates who have already had several economics courses; M.B.A.’s and other professional masters students, most of whom have several years of business experience; and Ph.D. candidates in economics, who have had years of formal disciplinary training – as well as with businesspeople in training seminars and executive education courses. Only five percent – *five percent!* – of the respondents made the right decision. Why did they get it wrong? In some cases, because they didn’t know how to get started. In other cases, because they used a wrong decision rule.

Experience has taught me that many of you will have to unlearn what you may already “know” in order to be able to learn what *really* to do in making decisions like these. Bottom-line decision-making is about setting the right objective, maximizing and

optimizing appropriately, estimating the benefits and costs of possible courses of action, and using correct decision rules. In this book, I'll teach you these decision tools.

In summary

The messages presented in this book deal with two major issues. The first messages are about what to maximize – in other words, what the organization's bottom line really is. The second messages are about how to maximize – in particular, how to make sound decisions when you, those who lead you, and those whom you lead are all clear about what your organization is trying to achieve.

Needless to say, if you help the organization achieve that bottom line, you will be a valuable and valued member of the organization. You will probably find the work intrinsically rewarding and be well-rewarded for it.

You will be a bottom-line manager, of yourself and of others, when you:

- Know what type of organization you are working for.
- Are clear about what your organization's bottom line is.
- Maximize the true bottom line and optimize everything else.
- Use sound decision rules and avoid unsound ones.

This book will help you become that kind of manager.

Notes

The FranklinCovey study is reported in *Workforce Magazine*, May, 2003, p. 80.

The Watson Wyatt study is *WorkUSA™ 2002 Survey*, available online at <http://watsonwyatt.com/news/press.asp?ID=10390> .

For the Dutch data, see Kees Cools and C. Mirjam van Praag, "The Value Relevance of Disclosing a Single Corporate Target," Tinbergen Institute Discussion Paper TI2003-049/3.

The Bossidy-Charan quotation comes from Larry Bossidy and Ram Charan, *Execution: The Discipline of Getting Things Done*. (New York: Crown Business, 2002).

The Gerstner interview was published in the November 18, 2002 issue of *Business Week*, pp. 64 and 68.

"The Business of Giving" was published in *The Economist*, February 25, 2006. The Collins quotation comes from Jim Collins, *Good to Great and the Social Sectors* (Boulder, CO: jimcollins.com, 2005).

The GAO quotation comes from Results-Oriented Cultures: Using Balanced Expectations to Manage Senior Executive Performance, GAO-02-966, available online at <http://www.gao.gov/cgi-bin/getrpt?GAO-02-966>.

“Winning Decisions” is the title of a book by my Cornell colleague Jay Russo and Paul Schoemaker of the University of Pennsylvania.

Chapter Nine.

Bottom-Line Management: An Executive Summary.

In this final part, I offer you an executive summary of the book's highlights. The central messages are highlighted in twenty takeaways.

Having read this book and become a Bottom-Line Manager, you are prepared to apply your new knowledge. Remember that many of the people out there are not as knowledgeable about Bottom-Line Management as you now are. They will need to have good decisions explained to them.

Communicating bottom-line decisions is actually quite difficult. Here's a suggestion for you, one that I often follow myself. Think of your earlier self. Before you figured out the answer systematically, what would you have thought? In explaining something to somebody else, prepare an oral presentation or written memorandum explaining *to your earlier self* what the answer to the problem is. Equally importantly, explain to your earlier self why you *shouldn't* have done one thing and why you *should* do another.

Believe me, it's not easy. But think of what doing it gets you: You show your awareness of the organization's bottom line, you demonstrate knowledge of the complexity of the problem at hand, you make good calculations, and you offer good explanations. Many managers can't do it. Why shouldn't you be the one to present this information and analysis? If you do, you really and truly will earn a seat at the table.

Here, then, are the twenty takeaways:

Bottom-Line Manager Takeaway #1: Bottom-line management is about purposeful behavior. It deals with two major issues. The first is what to maximize. The second is how to maximize.

Bottom-Line Manager Takeaway #2: Many organizations have a true bottom line. Many bottom lines consist of a single overarching purpose. Your job is to help the head of the organization do his or her job, which is to attain or improve upon that overarching purpose.

Bottom-Line Manager Takeaway #3: Nearly always, the objective *is* to maximize the bottom line *total*. The objective is *not* to maximize the bottom line per unit of output, per employee, per dollar of capital invested, or anything else.

Bottom-Line Manager Takeaway #4: Organizations' bottom lines can be classified into five types:

- Category 1: Profit-seeking companies
- Category 2: Single-purpose not-for-profit organizations
- Category 3: Dominant-objective organizations
- Category 4: Double (or multiple) bottom-line organizations
- Category 5: "Can't tell" organizations

Which type of organization is yours?

Bottom-Line Manager Takeaway #5: If you work in a company, you should assume that its bottom line is profit and act accordingly. Profit *is not* revenue, productivity, cash flow, return on investment, fiscal responsibility, value, or anything else. Profit *is* revenue minus cost, now and in the future. If the bottom line is not profit, someone will almost surely tell you. You should then act according to *that* (assuming that the person who has told you is correct in articulating what the true bottom line is).

Bottom-Line Manager Takeaway #6: In a well-managed organization, everybody is completely clear about what the organization's bottom line is, and they work at all times to try to achieve it. Once you know what your organization's bottom line is, manage yourself and those around you with that bottom line clearly in mind. If it is helpful, post the bottom line on your wall so that all who enter your workspace – most importantly, yourself – will know at all times what you're trying to achieve.

Bottom-Line Manager Takeaway #7: Organizations often conceal their true bottom lines behind mission statements, some of which are truly motivational, others of which are just plain mushy. Don't confuse the bottom line with the stated mission.

Bottom-Line Manager Takeaway #8: When your organization's bottom line is not clear, there is a good chance that people in the organization will do what they *think* is good for the organization rather than what is *in fact* good for the organization.

Bottom-Line Manager Takeaway #9: If you are working in an organization that lacks a clear bottom line, you and your people are probably working toward a presumed good. Understand that these presumed goods are probably not your organization's true bottom line. Be prepared to explain why a presumed good actually contributes to the true bottom line.

Bottom-Line Manager Takeaway #10: Any organization's bottom line is being maximized subject to constraints, both those imposed internally by the organization and those imposed externally by the marketplace. Be aware of the limitations imposed by your organization's ethics, values, and culture and honor them. If you can't honor them, find yourself another organization.

Bottom-Line Manager Takeaway #11: When you make a bottom-line decision, you maximize the bottom line and optimize everything else.

Bottom-Line Manager Takeaway #12: When you make a bottom-line decision, you do not maximize a ratio; you maximize a difference.

Bottom-Line Manager Takeaway #13: When you make a bottom-line decision, you do not maximize benefits or minimize costs. You maximize the difference between the two.

Bottom-Line Manager Takeaway #14: When you make a bottom-line decision, non-quantifiable benefits and costs are every bit as real as quantifiable ones, and so too are opportunity costs. Full account needs to be taken of all of these.

Bottom-Line Manager Takeaway #15: Whenever benefits and costs are not constant, which is most of the time, you should ask, what are the *extra* benefits and what are the *extra* costs if I do more (or less) of something? Then utilize a good decision rule that takes adequate account of the margins, being especially careful to treat sunk costs as invariable.

Bottom-Line Manager Takeaway #16: There are three good decision rules and many, many bad ones. Use one of the good ones.

Bottom-Line Manager Takeaway #17: Returns on investments can be gauged using net present value or rate of return. The net present value rule *always* tells you what contributes the most to profit. The rate of return rule *sometimes works and sometimes doesn't*. So try whenever possible to use the net present value rule.

Bottom-Line Manager Takeaway #18: Product market, capital market, and labor market decisions are interdependent. To maximize the bottom line, you must consider all these markets together.

Bottom-Line Manager Takeaway #19: The bottom-line-maximizing solution is not necessarily one in which *any* component cost is minimized or any component benefit is maximized.

Bottom-Line Manager Takeaway #20: Bottom-line decision-making is primarily about thinking well *inside* the box. However, it's worth spending a bit of time thinking *outside* the box. You and your organization might be pleasantly surprised by what you come up with.

I am confident that your new skills as a Bottom-Line Manager will serve you and your organization well. I'd be delighted to hear how you have been helped. Best of luck.

Gary Fields