

# DESIGN OF A RESILIENT CORPORATION

***AJMAL BEG***

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Dedicated to my family



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# Chapter 1

## Introduction

Market environment dynamically changes and a corporation that does not adapt to the dynamically changing environment is thrown out of the market. A corporation that does not post a profit is harshly punished by the market. As soon as a corporation posts a loss, it is forced by the market to layoff large number of employees. As number of jobless people increases, more and more corporations start to post loss as people do not have the money to buy their products. Every corporation is forced to focus on short-term survival and profits. This publication explores different concepts which may help corporation survive by using strategies that focus on both short and long term growth.

The book is divided into different chapters dealing with different aspects of the think process.

### **Chapter 1: Introduction**

This chapter introduces the purpose and structure of this book.

### **Chapter 2: Resilient financial design**

This chapter focuses on the financial design of a resilient corporation.

### **Chapter 3: Resilient business buying strategy**

This chapter discusses the strategies that may be useful while deciding which business to buy.

### **Chapter 4: Resilient human resource policy**

This chapter focuses on human resource policy of a resilient corporation.

### **Chapter 5: Resilient business model**

This chapter focuses on business model of a resilient corporation.

**Chapter 6: Focus of a resilient corporation**

This chapter discuss the types of market a resilient corporation should focus on.

**Chapter 7: Selecting products**

This chapter discus what types of products a corporation should focus on.

**Chapter 8: Summary**

This chapter summarizes the finding of the previous chapters.

# Chapter 2

## Resilient financial design

This chapter focuses on the financial design of a resilient corporation.

### 2.1 Financial health indicators

Corporation financial health is defined using follow financial health indicators in this publication.

- Self-owned assets
- Borrowed assets
- Income from doing business
- Cost of borrowed assets

Let's explain the relationship among these financial health indicators.

- A corporation uses self-owned assets and borrowed assets to do business.
- The borrowed assets are in the form of money.
- The corporation earns income in the form of money from doing business. The income from doing business can be both positive and negative.
- The corporation pays the cost of borrowed assets to the lenders in the form of money.

To make it easy to understand the concepts presented in this publication, let's make follow assumptions:

- Income from doing business is determined at the end of a financial year.
- The corporation has always positive income from doing business.
- The borrowed assets remain with the corporation throughout the financial year.

Figure 2.1 illustrates a corporation in two different states. Left of Figure 2.1 illustrates the initial state of the corporation. The borrowed assets and the self-owned assets are assumed to have equal values. Right of Figure 2.1 shows the corporation in decline after some time. A corporation with following characteristics is defined as a corporation in decline, in this publication:

- The borrowed assets do not decrease but remain almost constant at the end of the financial year.
- There is significant decrease in the value of the owned-assets at the end of the financial year.

The decrease in the value of the self-owned asset is the only indicator that this publication focuses on. A corporation is considered bankrupt at the point the value of the self-owned asset turns zero. In the coming sections, different mechanisms that lead to the reduction of self-owned assets are discussed. Different ways to prevent the decrease in the value of the self-owned assets are discussed.

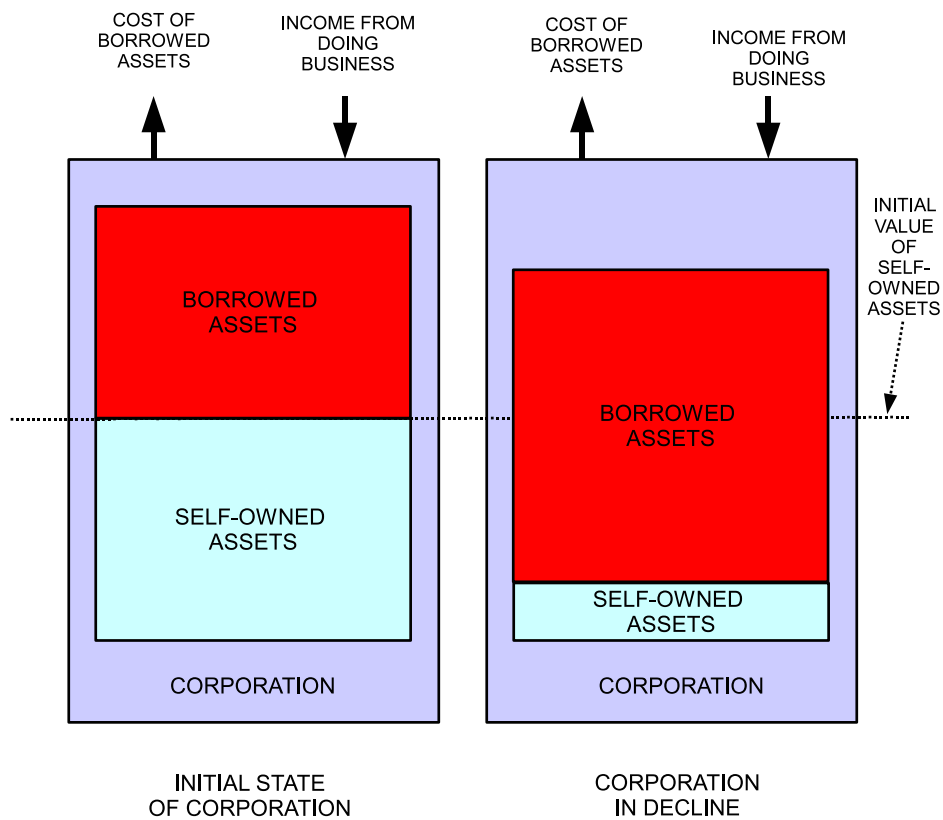


Figure 2.1: Financial health indicator

## 2.2 Impact of borrowing

Figure 2.2 illustrates two cases. In the first case, the cost of borrowed assets is larger than the income from doing business.

- The corporation uses a part of self-owned assets for serving the cost of borrowing.
- The self-owned assets decreases as a result of this.
- The self-owned assets drop to zero in case the cost of borrowed assets keep on surpassing the income of doing business. The corporation is considered bankrupt at this point.

In the second case, the cost of borrowed assets is less than the income from doing business.

- The corporation does not need to use a part of self-owned assets for serving the cost of borrowing.
- The difference between the income from doing business and cost of borrowed asset is used to increase the self-owned assets.

To understand how cash flows in an economy, let's assume

- A market consisting of Corporation A and Corporation B.
- The total capital value of the market remains constant during a year.

Figure 2.3 illustrates the flow of cash in the market.

- Corporation is represented as a glass jar containing water.
- The quantity of water in the jar represents the total self-owned assets.
- One glass jar is connected to the other glass jar. Water from one glass jar can transfer to the other jar.
- The total volume of water contained in two jars is constant.

Left of Figure 2.3 shows the condition of market at the beginning of the year. Right of Figure 2.3 shows the condition of market at the end of year. Figure 2.3 shows that:

- One corporation's loss is another corporation's gain.
- The assets move from one corporation to another.

- At a certain point in the life of the corporation, the corporation is expected to post a loss in a fair and free market environment.
- There is no way a corporation can keep on making profits forever. Posting a loss is not a crime for which a corporation be punished by market. There is need for a mechanism to deal fairly with corporation when they have to post a loss.

Once we know that it is not possible to avoid a loss, let's discuss about what can be done to avoid any significant reduction in the self-owned assets.

- More assets can be borrowed to cover the cost of existing borrowed assets. However, this is not the optimal solution as it will further increase the risk of reducing the self-owned assets to cover the cost of newly borrowed assets in near future.
- Ask the lender to reduce the cost of borrowed assets.

Asking the lender to reduce the cost of borrowed assets has some serious issues associated with it:

- A corporation might be in its current bad financial position due to making unwise business decisions. A lender cannot be punished for unwise decisions made by a corporation.
- A corporation can blame the lender for investing in businesses which were not viable.
- Before a lender is asked to reduce the cost of borrowing, there is need to determine who is responsible for the loss. Determining and quantifying the contribution can be a lengthy process. A corporation can be thrown out of the market before the lengthy process of making some assessment is complete.
- A lender can also object that why do not the corporation increase the cost of borrowed asset, when the corporation was making huge profit from the borrowed assets and why lender needs to share the burden of loss only.

These issues can be resolved by using follow approaches:

- Lender and the corporation borrowing from the lender enters into an agreement that allows sharing of both loss and profit.

- The lender is given right to participate in the decision making process related to business conducted by the corporation. With such method, the lender and the corporation both share the responsibility. It will help avoid going through the lengthy process of determining who is responsible for the loss when a corporation is already facing a serious financial crises.
- As lenders are generally more experienced in conducting business, participation of lender in the business should help improve the income from doing the business.

The relief from the lender can be in two ways:

- Reducing the amount of borrowed assets itself.
- Reducing the cost of borrowing.

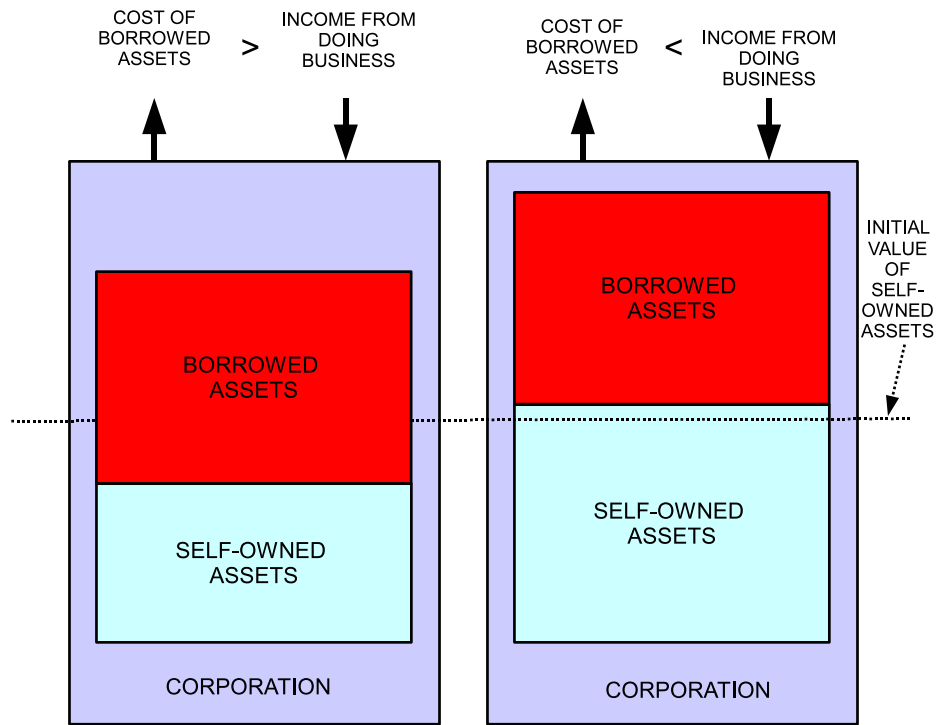


Figure 2.2: Impact of borrowing cost

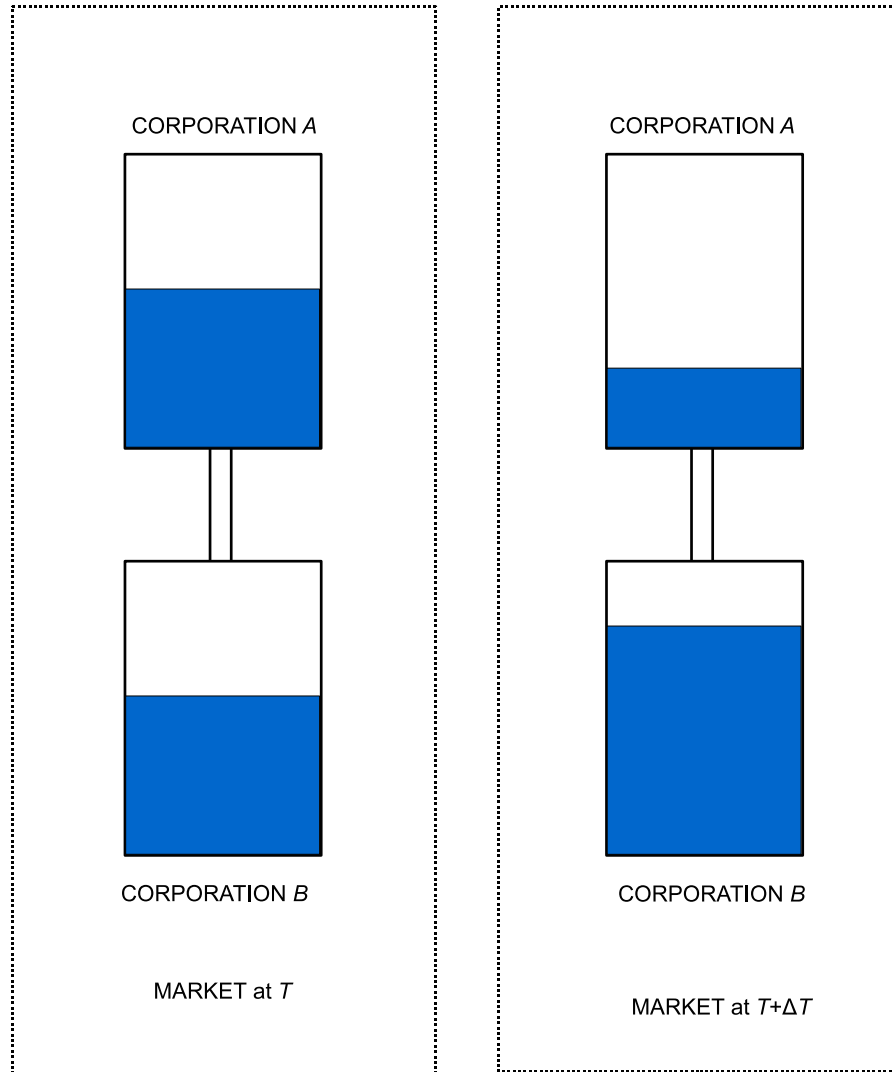


Figure 2.3: Flow of cash

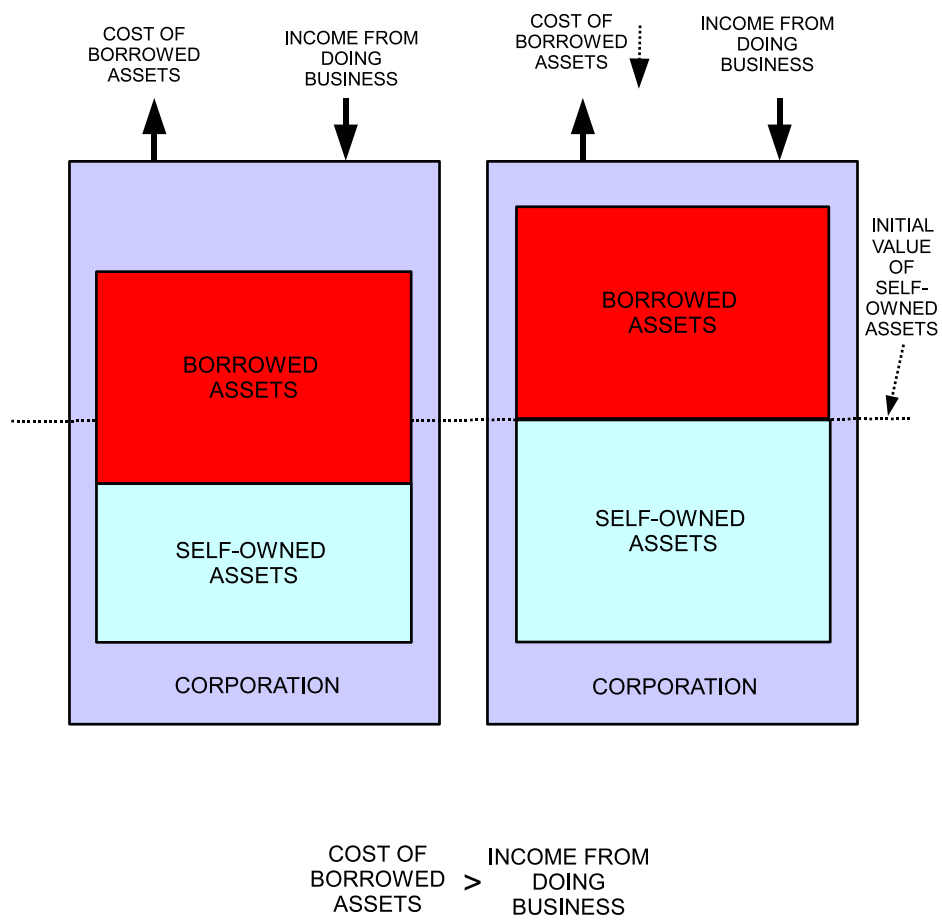


Figure 2.4: Strengthening the finance of corporation during decline

## 2.3 Impact of deflation

This section looks at the impact of deflation on a corporation. Left side of Figure 2.5 illustrates a corporation before the deflation. During deflation:

- Income from doing business reduces as the price per product drops, so is the value of the self-owned assets.
- The cost of borrowed asset remains same. It forces the corporation to use a part of the self-owned assets as the cost of borrowed assets.
- The value of the self-owned assets starts depleting quickly as a result of drop in the value of the self-owned assets and by using a part of the self-owned assets as cost of borrowed assets. The borrowed assets keep the same value as before as those were borrowed in form of money.

To fight deflation, usually the cost of borrowed assets (such as interest) is reduced. However, reducing cost of borrowed assets has some limitations:

- The profit from lending reduces and it becomes unattractive to lend money to the corporation.
- As a result of this, the new investments dries and the lenders move cash to the investment areas such as emerging markets for better returns on investments.

The deflation can be better fought when:

- The amount of borrowed assets is reduced too when the value of self-owned asset decreases. The cost of borrowing will be automatically reduced when the value of borrowed assets is reduced.
- When the economy is out of deflation, the value of the borrowed asset is adjusted upward according to the market.

Such mechanism is only possible when:

- The lender and corporation decide how to adjust the value of the borrowed assets and the self-owned assets during the deflation and after the deflation before engaging in a business deal.
- The lender and the corporation decide about how to link the cost of borrowing to the value of the borrowed and self-owned assets.

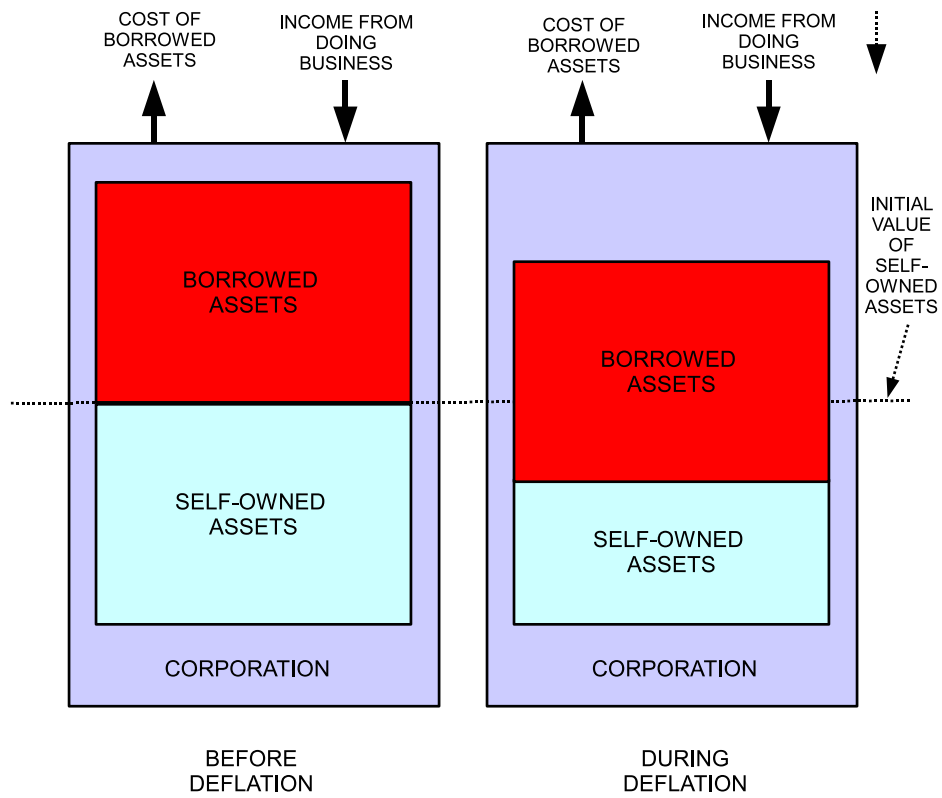


Figure 2.5: Impact of deflation

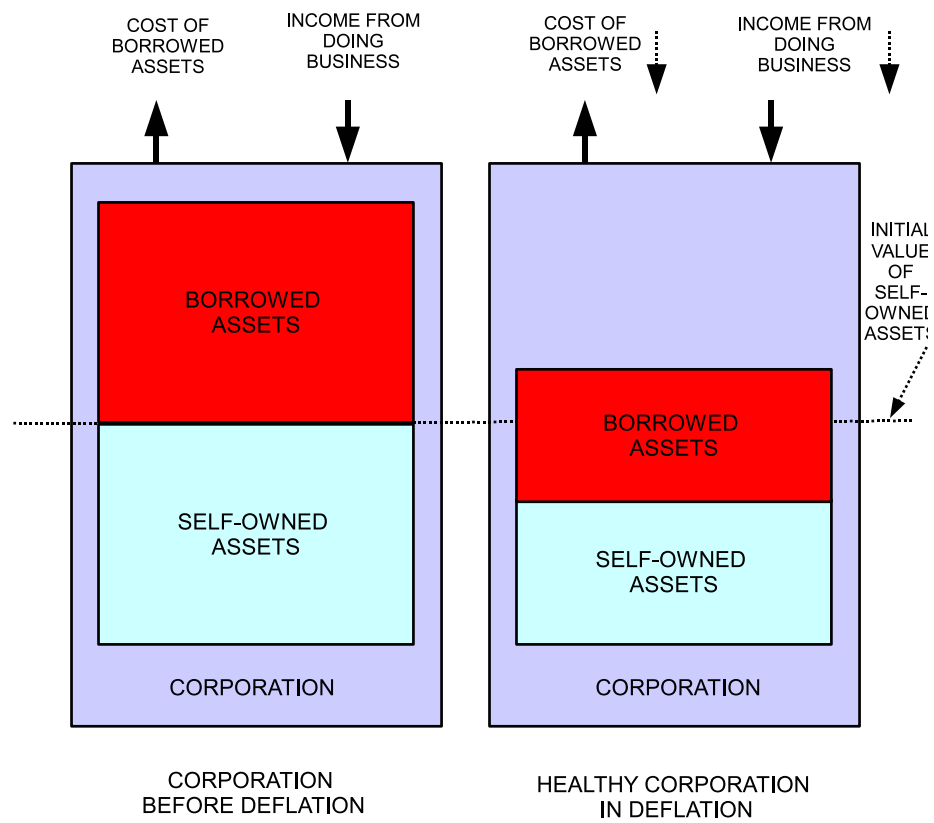


Figure 2.6: Strengthening the finance of corporation during deflation

## 2.4 Impact of inflation

This section discusses the impact of inflation on the financial health of a corporation. Figure 2.7 shows the short-term impact of inflation.

- As the price per unit of product increases, the income from doing business increases. The value of the self-owned assets also increases when those are not in the form of currency.
- The cost of borrowed assets remains almost same as the value of borrowed assets remains fixed.

Figure 2.8 illustrates the impact of inflation on borrowing.

- Inflation benefits only the corporation. To compensate the lenders, the cost of borrowing is increased such as increase in interest rates.
- The increased cost of borrowing decreases the profits of the corporation.
- Any borrowed assets lose their market value in the terms of purchasing power when the interest rate is below the inflation. In such case, the corporation faces issues securing new borrowed assets for new investments as the lenders invest in markets with high return on investments.

Figure 2.9 shows the relationship between wages, inflation and the income from doing business.

- When wages increases more than the value of the inflation, the income from doing business continues to increase.
- When wages does not increases at the same rate as the inflation, the income from doing business starts to decrease. It leads to the reduction in income from doing business in terms of purchasing power. Any reduction in income leads to depletion of self-owned assets.

Figure 2.10 shows different components of living cost of consumers. The inflation impacts most of these components.

Corporation can survive in the inflation by using follow approaches:

- Adjust the value of the borrowed assets according to the inflation rate, so the lender do not stop lending. The lender and the corporation need to have an agreement about how to adjust the value of the borrowed assets before engaging in a business deal.
- Increase the price of the products only to the extent of actual increase in the cost of borrowed assets.
- Adjust the salaries of the workers according to the actual inflation rate.

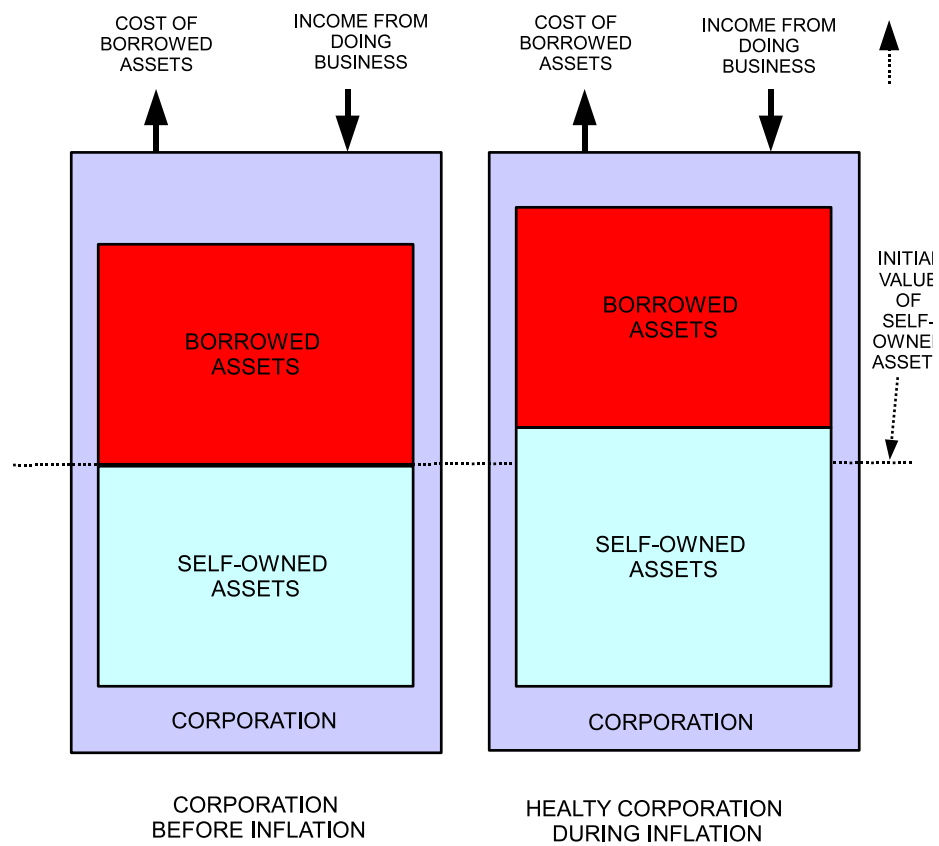


Figure 2.7: Healthy business in inflation

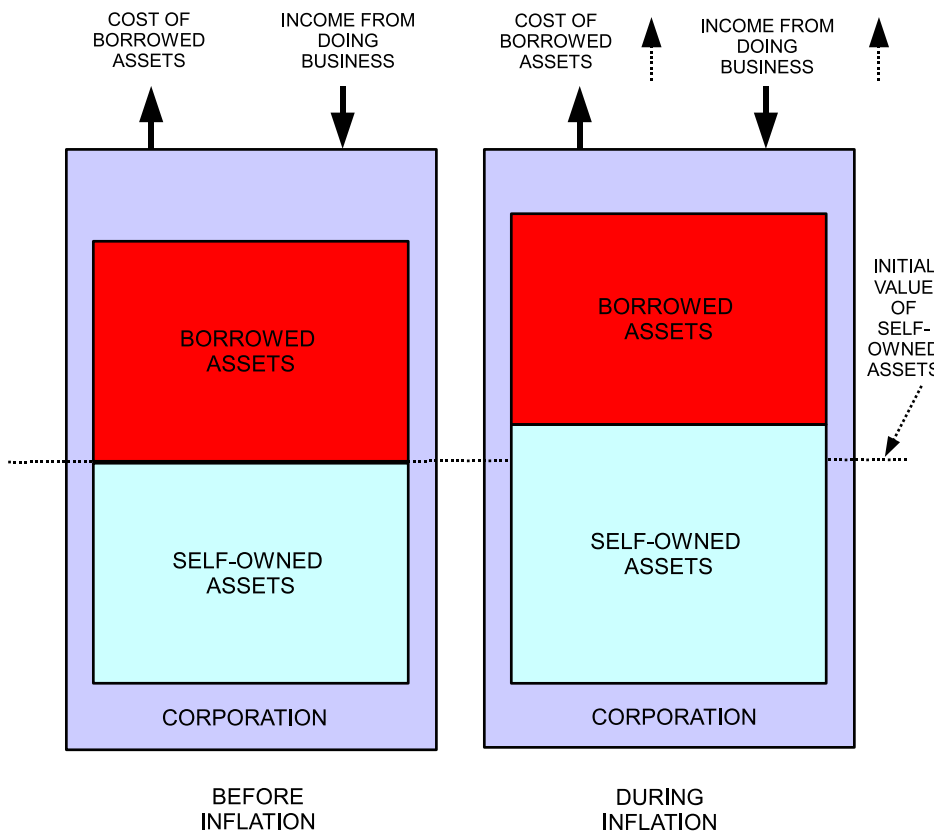


Figure 2.8: Impact of inflation

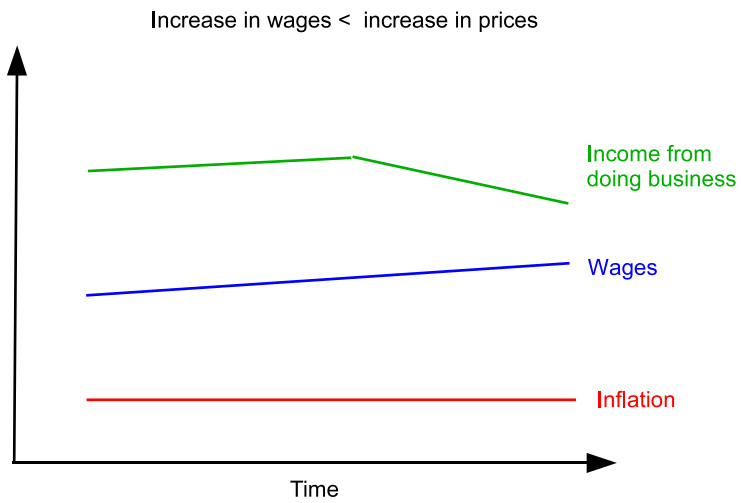
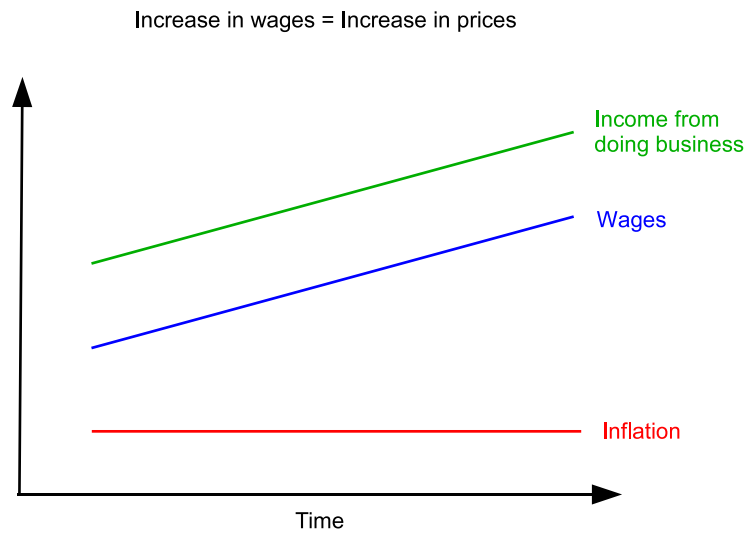


Figure 2.9: Wages and inflation

Calculating rate of inflation

Housing cost
Food cost
Education cost
Medical cost
Transportation cost
Communication cost
Entertainment cost

Figure 2.10: Calculating inflation

## 2.5 Form of self-owned assets

It is important to keep self-owned assets in a form which does not result in reduction in the value of self-owned assets with the passage of time. It is also important to keep assets in a form which increase its value over time and does not fluctuate greatly.

## 2.6 Long term commitments of lenders

Let's assume a case where a corporation secures funding of 10 million dollar with a condition that the lender can ask for his investments back anytime. Let's assume corporation invests this 10 million on a project that will become profitable in next 3 years. In case, the lender asks for his funds back before 3 years, the corporation will have to reduce self-owned assets to pay back borrowed money. It is always good to make the lender commit the funds for longer period of time.

# Chapter 3

## Resilient business buying strategy

It is quite common practice to buy other business using the income from the business or using self-owned assets. This chapter discusses the strategies that may be useful in protecting the self-owned assets.

### 3.1 Actual market value of a business

Let's see what components form a business that is bought using income from business or self-owned assets. The debt that is owned by the business is excluded from the discussion here.

- Land/Resources the land contains
- Building
- Equipment
- Products
- Intellectual Property
- Material
- Employee
- Customers
- Reputation

Let's look at each of the component in detail.

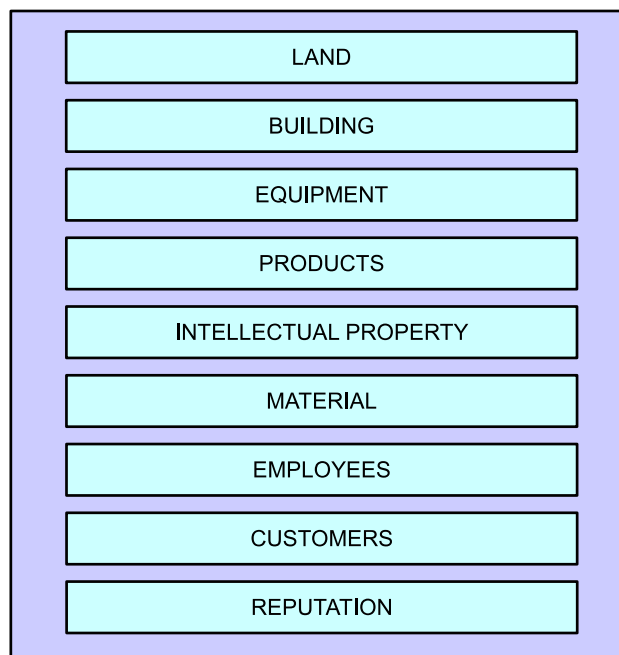


Figure 3.1: Company assets

### **3.1.1 Land**

The land possessed by a business is a long term asset. Proper assessment is needed to be done to assess the short term and long term value of the land. The value of the land may go down in long term or it may increase in the long term.

### **3.1.2 Building**

Buildings can be long term or short term assets depending on their condition. A building that can be used in long term is a long term asset. A building that cannot be used for long period of time is like a liability. A proper assessment is required to assess the actual value of the buildings.

### **3.1.3 Equipment**

Equipment possessed by a business can be a long term or short term asset depending how long it can be used. Most of the equipments are short term assets.

### **3.1.4 Products**

Products produced by a business are generally short term assets. For most types of businesses, most products have short lifecycle and cannot be treated as long term assets. Having good market for one product today, does not mean that all future products from this particular business will have good market share. It is because whenever a company is successful in marketing a product; the competitors are expected to flood the market with clones of such product. It is important to determine how long the product can sustain high share in the market.

### **3.1.5 Intellectual Property**

There are always different ways to achieve the same objective using different methods. Possessing an intellectual property does not mean, that one can stop other people from developing an alternative. A proper assessment is needed to determine the true value of the intellectual property of a business. Most intellectual property is protected in limited geographical areas due to high cost of obtaining protection (such as patents, design patents) in multiple countries. Everyone is free to use domestically the intellectual property that is protected in overseas market only.

### **3.1.6 Material**

Material is consumable and is a short term assets.

### **3.1.7 Employee**

Dedicated, hardworking and innovative employees are the biggest asset of a corporation. Whenever a business is bought, the new owners try to reduce the cost by reducing the number of employees. As the new owners have very limited knowledge about who are the employees who have been driving the innovations, many innovative employees are asked to leave. Such employment terminations reduce the long term value of the corporation drastically. It is a free world. The employers are free to terminate employments and the employees are free to move whenever they like. There is generally change in the working environment when a business has new owners. Many employees may want to leave when they do not adjust easily to new management.

### **3.1.8 Customers**

Due to adaption of free economy principles, the customers can choose from different products coming from different sources. Customers do not have any moral obligation to be a loyal to a specific brand indefinitely. When a business moves from one owner to another, there is generally a change in the quality of services and products. A proper assessment is needed to see what will be the result of change in the quality of services and products once a business is bought by a corporation.

### **3.1.9 Reputation**

In todays world of advanced communication means, a company reputation can change very quickly. Current good reputation is a short term asset, while an existing bad reputation is a long term liability. Proper assessment is needed to assess the long term reputation of a business.

## **3.2 Summary**

As seen above, there are very few types of assets which may be profitable in the long term. Using self-owned assets to buy a new business is quite risky for long term health of a corporation. There is need for very careful assessment before deciding to buy a new business at a specific price. In most

cases, a newly bought business is expected to become a long term liability when proper assessment is not conducted at the time of acquisition.



# Chapter 4

## Resilient human resource policy

This chapter focuses on human resource policy of a resilient corporation.

### 4.1 Experienced employees

It is a very common concept in modern economy, that computer systems can replace completely the wisdom of human beings. Such philosophy is implemented by different means such as:

- Standardize the way the business is conducted.
- Automate the standardized process.

Business software such as ERP implements both of these steps. Business software is a collection of standardized automatic business processes. Such standardized automatic business processes are available to every corporation. In the market, every corporation possesses somewhat similar standardized automatic business process. As a result of this, every corporation thinks and acts in the same way. In other words a corporation has limited edge over another corporation as they think and act in the same way. As standardized automatic business processes are introduced;

- The human wisdom/work experience loses its value in the corporation.
- Employees with human wisdom/work experience are replaced by low cost operators who operate standardized automatic business processes. Such approach increases the profits in the short term.

Figure 4.1 illustrates what an employee with human wisdom/work experience possesses. Automated standardized processes do not provide these capabilities.

- Ability to apply knowledge from one domain to another.
- Ability to select solution from large number of solutions.
- Human relationships/network.
- Ability to merge knowledge in an innovative manner.
- Ability to foresee coming events.
- Loyalty, trust and passion.
- Ability to remove unnecessary details.
- Ability to prioritize.
- Desire to transfer soft skills.
- Emotional maturity
- Ability to apply knowledge in a non-standard way

By replacing employees with low cost operators of standardized automatic business processes, a corporation loses its long term competitive edge in the market.

## 4.2 Contractor vs. permanent employees

There is a strong trend in the market to use short-term contractors rather than hiring permanent employees. The contractors do not appear as long term cost on the corporation balance sheet and it helps corporation show good short-term outlook. However, the contracted resources cost much more than the permanent employees. Figure 4.2 illustrates the focus of contractors to able to maintain their income stream besides doing their existing contracted work.

- Build relationships to have the contract extended.
- Build relationships to have a new contract outside of the existing organization.
- Try to maximize the income from the existing contract.
- Give priority to developing highly paid skills for future contracts.
- Maintain reputation.

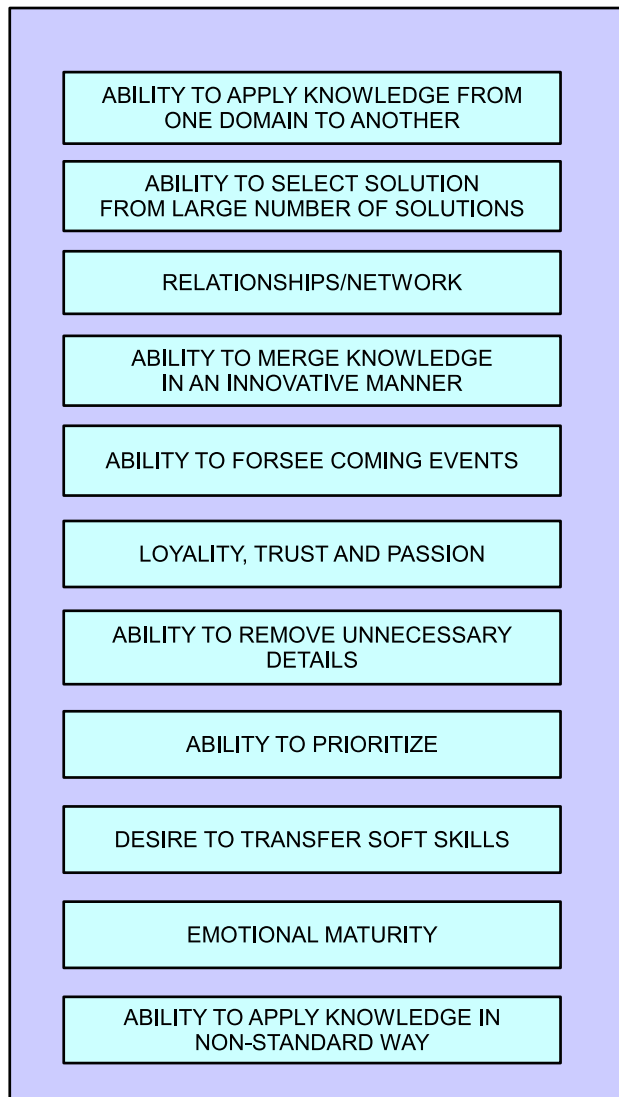


Figure 4.1: Experienced employee

The employees of a corporation may only contribute to the long-term growth of a corporation when:

- The long-term benefit of the corporation will benefit the employees too.
- The employees are sure that the corporation is as loyal to them as they are loyal to it.
- In economic hard time, employee wont be asked to leave.

Any future growth of a corporation does not benefit short-term employees like contractors. A workplace where most of the workers are short-term employees does not produce a resilient corporation. To design a resilient corporation there is a need to:

- To prefer long-term employment over short-term employment.
- Protect the employment of employees during the hard economic times to reward them for being innovative for long term profits of a business.

### 4.3 Protecting employees during hard times

It is a trend that as soon as a corporation posts a loss, corporation terminates the employment of significant number of employees. Such practice reduces the long-term liability of the corporation on the balance sheet, however as a result of such measure, a corporation lose many employees who were the real assets of the corporation. Many corporation might think that they can rehire their former employees again when the economy improves, however it does not happen due to several reasons:

- Employees find other corporation which values them more.
- Employees gain new skills and move to other professions.
- Employees start their own companies with the help of their friends and families.

To build a resilient organization, it is important not to lay off employees to improve the long-term balance sheet outlook. A resilient corporation make long term plan to cope with the rainy days. As shown in Figure 4.3, a resilient corporation keep aside two types of funds during the good days.

- New product seed fund

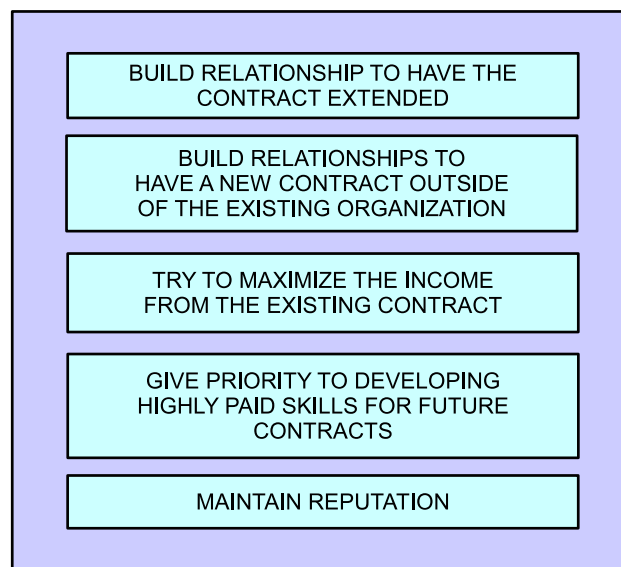


Figure 4.2: Focus of a contractor to maintain income stream

- Retraining fund

New product seed fund is used to explore new products/markets/ideas during economic hard times. Retraining fund is used to retrain employees according new market conditions during the hard economic days. In some countries, public schemes like employment insurances provide funds for retraining unemployed person. However, as discussed above once loyal and innovative employees with good experience leave the company, in most cases they do not return to their original workplaces.

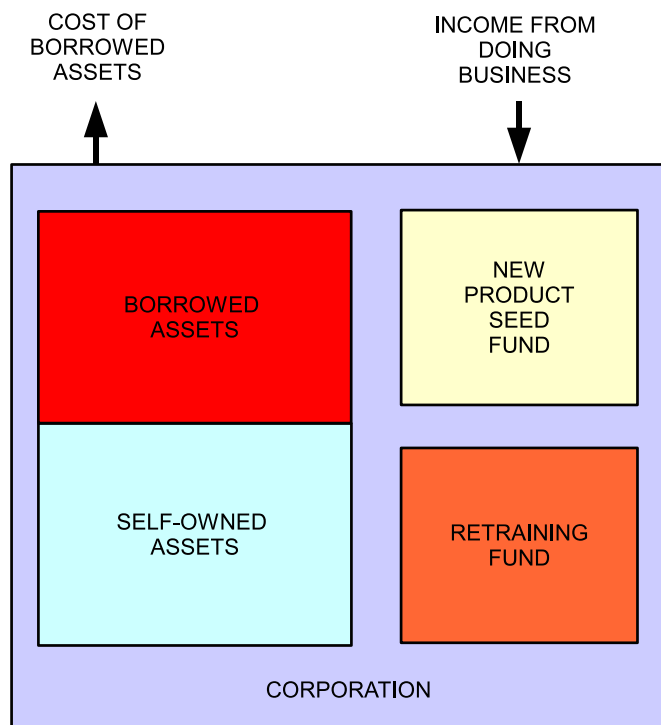


Figure 4.3: Saving for raining days



# Chapter 5

## Resilient business model

This chapter focuses on business model of a resilient corporation.

### 5.1 Need for switching business model

Business environment is not static but always changing. When business environment changes, the corporation operators instantly know that the corporation need to switch to a new business model. However, any switching of business model takes a long time. A business may have irreversible financial damage before switching from one model to another is complete. There are some reasons for it:

- The business system realizes business models.
- Switching from one business to another requires change to business systems.
- Most of times the used business systems are not internally developed and changing them is not feasible.
- It requires significant time and money to adapt the business system to new business model.

Top of Figure 5.1 shows switch from one business model to another business model. Traditional way of switching to a new model of business may not only take time but will also reduce the market share. Bottom of Figure 5.1 illustrates a swift switch from one business model to another. Switch from one business model to another should takes less time and does not reduce the market share significantly.

Figure 5.2 illustrates a resilient corporation which has flexibility to switch from one business model to another model very swiftly and without losing its market share. This resilient corporation has follow characteristics:

- The corporation has multiple business units.
- All big business units adopt the same business model.
- There are a few small independent business units who adopt different business models than the business model adopt by the big business units. These a few small independent units have relevant infrastructure (business systems etc) in working condition.
- When there is need to switch to a new business model, big business units copy the business model and relevant infrastructure from one of the small independent business unit.

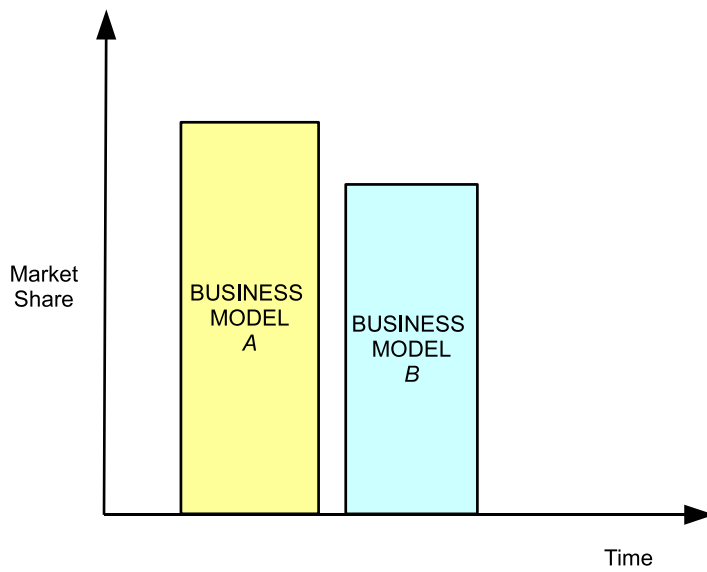
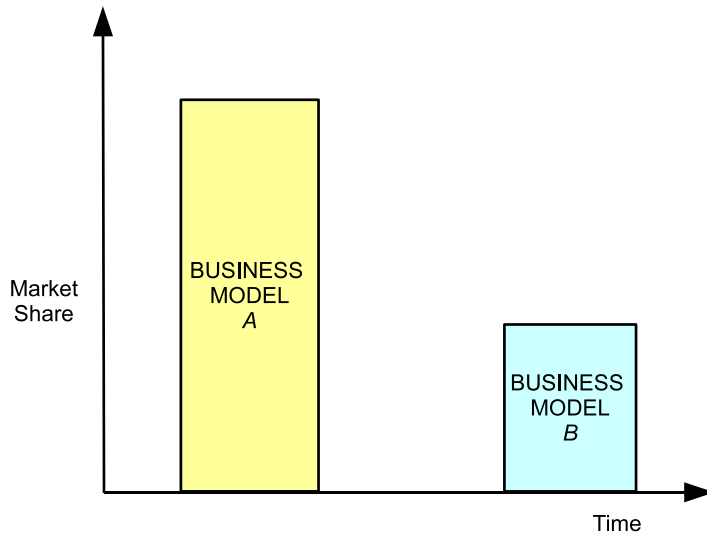


Figure 5.1: Switching to a new business model

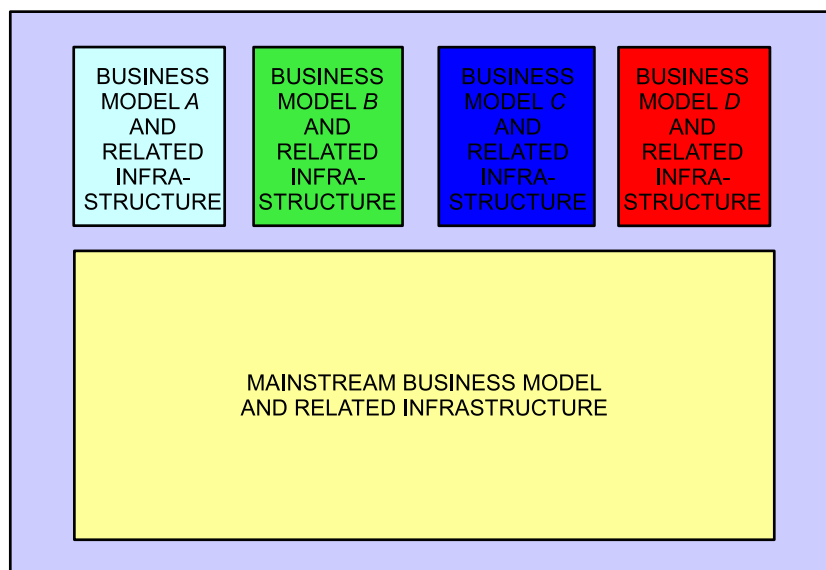


Figure 5.2: corporation with multiple business models

# Chapter 6

## Focus of a resilient corporation

This chapter discusses the types of market a resilient corporation should focus on.

### 6.1 Producing clones by chasing foreign markets

It has been strongly believed that a corporation can grow continuously by setting up businesses overseas. Figure 6.1 illustrates different steps a local market goes through when a foreign corporation starts introducing new types of products in the local market.

- Sales team are formed.
- As there is need to replace parts, the import of spare parts begins.
- The services teams are formed.
- Local manufacturing of simple parts start.
- Local manufacturing of sophisticated parts start.
- Designing of simple parts starts.
- Designing of sophisticated parts starts.

After certain time, a local market has all the skills and the infrastructure needed to produce a local clone of a product from a foreign corporation. Sooner or later local companies start producing clone products. The quality of cloned products improves gradually and after a while the local products push the foreign product out of market. Figure 6.2 illustrates how with the

passage of time, the number of clones increases and the international market share drops. Furthermore, in bad economic times the consumers become nationalist and do their best to buy the local products even when they have to compromise for quality. The income from doing business overseas can produce profits but that profit is not long lasting. The only place where a corporation can expect long term business is the local market which is supported by the local community in the long term. A resilient corporation needs to make careful planning about where to invest for the short-term profits and where to invest for the long-term profits.

## 6.2 Building positive image in foreign market

Figure 6.3 illustrates what happen when a corporation buys a foreign business.

- The foreign business start using shared regional services, which reduces the number of local employees.
- The import of low-cost material from other overseas centers starts which reduces business for local low-cost material sellers.
- If a high-cost material is being produced which can be produced somewhere else at lower cost, the high-cost material production is stopped. It makes some more jobless.
- The local business systems are discarded producing some more jobless people.
- The profit targets are set according to global profit targets. Local employee may not be comfortable with those targets.

Due to above social impact, the corporation which bought the local business becomes a villain in the eyes of local people. To improve the negative image, a foreign corporation need to build a positive image that shows that it cares about the local people. Figure 6.4 illustrates how a foreign organization can use some of its earning to do charity work to improve its image.

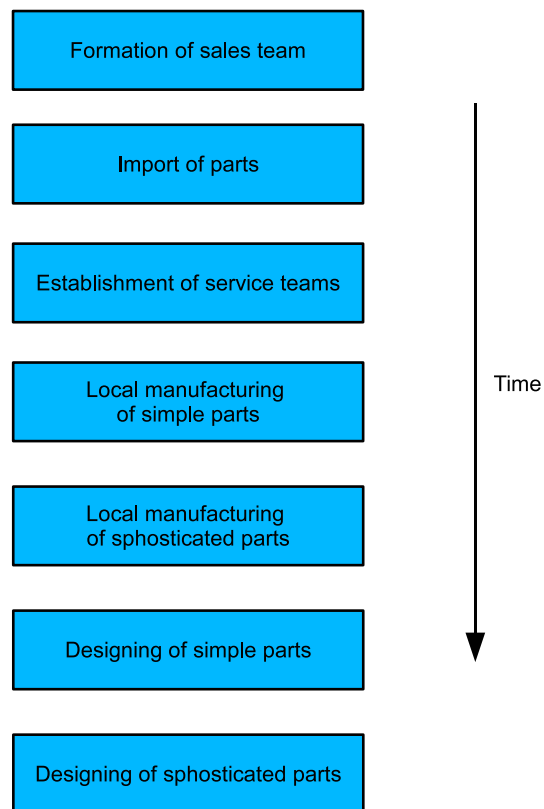


Figure 6.1: Birth of clones

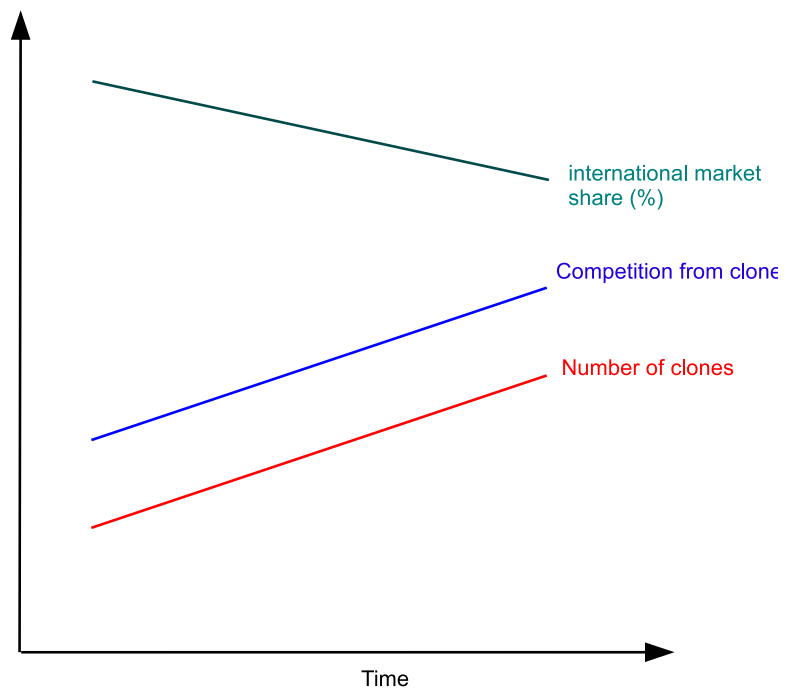


Figure 6.2: Clones and market share

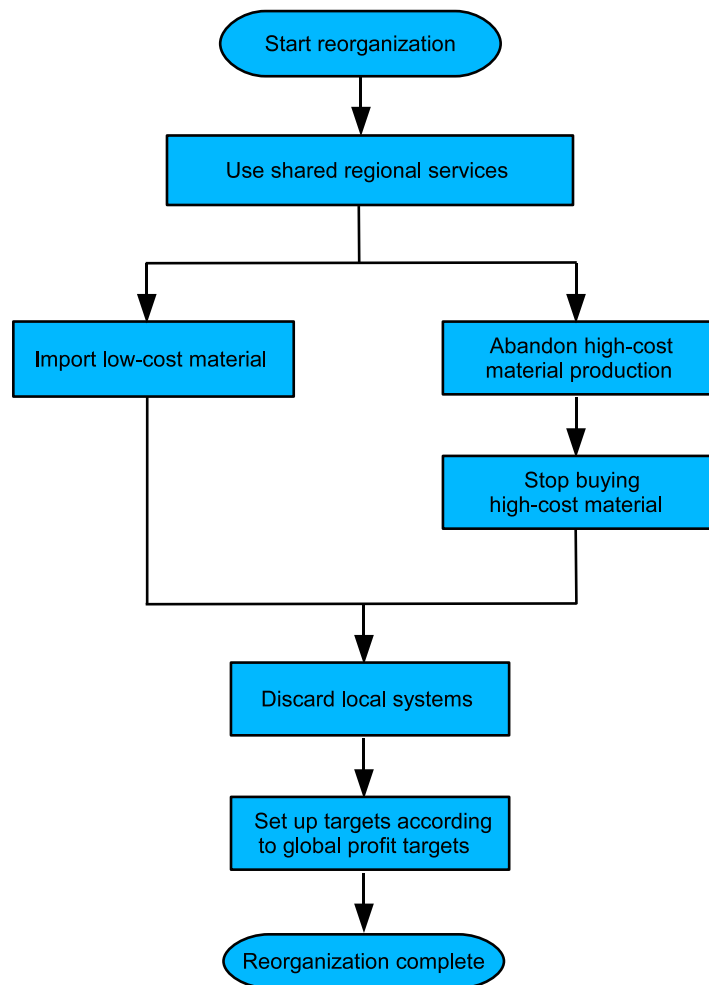


Figure 6.3: Buying a foreign company

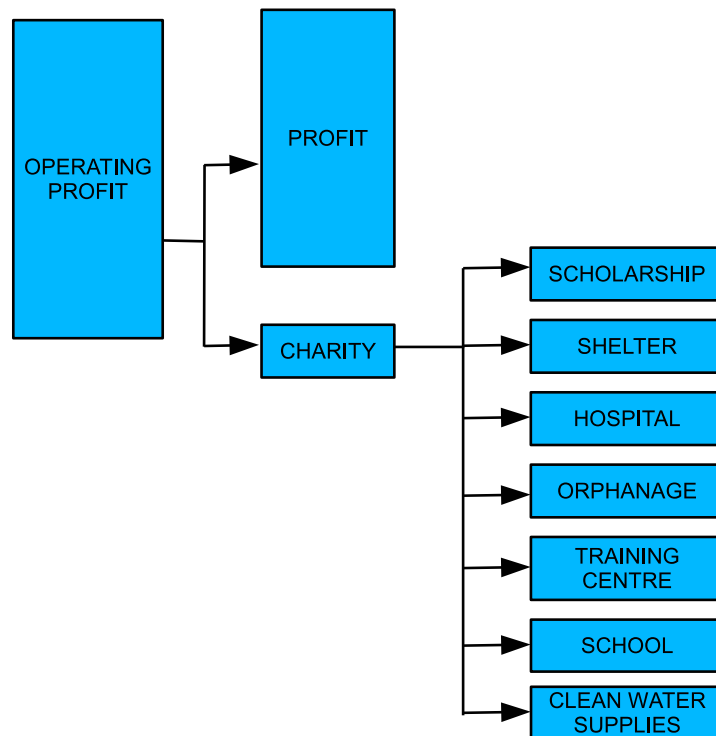


Figure 6.4: Building a positive image

# Chapter 7

## Selecting products

This chapter discuss what types of products a corporation should focus on.

Figure 7.1 categorizes products into different categories according to their need in daily life and their cost in terms of purchasing power. The products which are low in cost (category with green background) are the products that are expected to be sold during economic hard times. As economic conditions change very quickly and without much warning, a resilient corporation produces products belonging to all six categories and adjusts the volume of production according to demand of that times. This method can help a corporation survive in all economic conditions. While designing products, it is important to determine the extent of effort that is needed to replicate a product. Any product that can be replicated by competitors without much effort can bring profits for very limited period of time. Products that are difficult to replicate can bring profits over extended period of time.

Basic Life Necessaity	Retail price in terms of purchasing power	Share (%)
YES	HIGH	A %
YES	MEDIUM	B %
YES	LOW	C %
NO	HIGH	D %
NO	MEDIUM	E %
NO	LOW	F %

[A|B|C|D|E|F] ≠ 0 %

A + B + C + D + E + F = 100 %

Figure 7.1: Target market for products

# Chapter 8

## Summary

This publication introduces some strategies that may help build a corporation that can survive in both recession and economic booms. This publication focuses on strategies for different aspects of a business such as:

- Financial model
- Strategy to buy other business
- Human resource policy
- Business model
- Focus on local and overseas business
- Selection of products

