BY JOHN LOWRY
CONTRIBUTING EDITOR
LOWRY@CHEMARKCONSULTING.NET

The dynamics of business revenue

Understanding the dynamics of revenue stream is an essential part of a company's planning process.

This is the time of year when many businesses start closing out the old year and begin the process of internal planning and budgeting for next year. This is a time consuming and in some cases, a painful process. All business plans, big or small, start with a projection of revenue for the planning period ahead whether it is for the next six months, one year or several years. Not surprisingly, the majority of business management/owners are looking for an increase in this important measurement—revenue growth.

While thinking about this subject I ran across a blurb at the bottom of the front page of a national newspaper, which said, "Many businesses have calculated that it is cheaper to gain a new customer than to maintain the 'old' ones." This was a surprise to me and got me thinking about what the real dynamics are behind revenue projection, especially in a mature market such as the coatings industry today.

A simple formula for determining revenue would be:

Next year's sales = Last year's sales + market growth

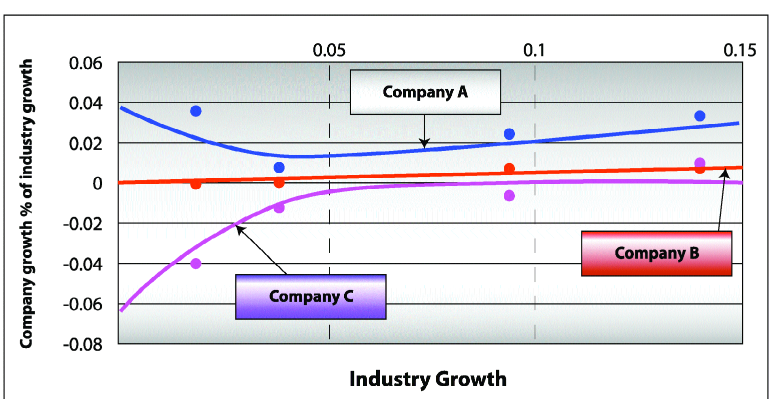
Now we all know that things are a little more complicated than that but if we really analyze it the situation is actually a lot more complicated than this equation implies and requires a much more in depth analysis. In reality this example measurement should be:

Next year's sales = Last year's sales +/- market growth (at existing customers) – lost customers (share loss) + gained customers not associated with market growth (share gain)

A much more complicated and realistic analysis would be further required to gain an in depth understanding of the dynamics of revenue projection if market growth is flat. Actually, there are several more terms that could be added to this equation including price dynamics.

Keeping these formulas in mind, imagine a company that had positive market growth at some existing customers but at other customers suffered volume loss or complete customer loss. Depending on the balance between these two factors a company can show positive growth, zero growth or negative growth. If these two turnover factors are large enough in the percent of total revenue then an extremely unstable situation can result. However, it is easy for them to balance out and therefore the total revenue picture looks sublime, even though there is underlying turmoil beneath a number that may or may not change much from year to year.

In our experience at Chemark, the budgeting process does not look beyond macro industry trends and their effect on their projected sales revenue. Just because you are in a low growth market does not mean the work of esti-



mating and maintaining sales goes down. On the contrary the effort required may go up.

In the figure on the previous page, which illustrates three competing companies participating in the same market arena, it shows the percent growth/loss of each company's sales as a percentage of the previous year's industry sales versus overall growth for the industry.

From this perspective companies can be broken down into three categories.

• *Market gainers.* Continue to grow regardless of market conditions (represented by Company A in the chart).
• *Market survivors.* Steady performance but little growth (represented by Company B in the chart).
• *Market Losers.* Can grow at higher market growth conditions but lose customers as conditions get tight (represented by Company C in the chart).

At the moment Company A is doing well in the market, Company B is struggling and Company C is now in Chapter 11.

Interestingly, these scenarios fit a variety of industries both big and small.

The solid lines model the individual company performance in terms of its ability to capture market during periods of high growth and its ability to capture share during periods of low growth. During times of low growth the data show that as much as 25% of existing market volume is in play and that the "market gainers" are very successful in capturing this "recycled" volume.

One of the prerequisites for growth is to not lose. All other alternatives result in extremely unstable situation, which can rapidly deteriorate as exemplified by the curves in the chart. Therefore, when budgeting revenue, which will of course drive the rest of the financial performance of your company, it may be worthwhile to attempt to understand the underlying dynamics of your revenue stream.

As you move into your planning process for either the short or long term, our experience suggests that an in depth understanding of the dynamics of your revenue stream can help in guiding your company's planning process. While things on the surface may seem placid, don't be fooled. Underneath the surface the situation may actually be very chaotic. Without this understanding you can easily be caught off-guard. **CW**