



# **The Fleeting Relationship of Property, Contracts, Cash and People**

*A financial guide about managing company resources for the non-financial professionals*

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Let's begin with a few thought provoking questions about what business is and what it is, or is not...

What is the essence of business?

How do you boil it down to what is most fundamental?

Is it your product or service, your people, your profitability, your services to the community?

Yes, these are all aspects of a business, but there are four basic elements that every business can be divided into—property, contracts, cash and behavior (people).

Since the last group, people, manage the first three, it seems essential that everyone at a company understands the relationship of the other three areas. Furthermore, people must understand how these areas are affected by individual and collective decisions.

How many people at your company can accurately describe these relationships? Property, contracts, and cash each has a story to tell about a business; each has a primary financial document that conveys the story; you just have to know how to read it...

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## Property

Property represents the things a business possesses; its story is told by the company balance sheet. A more accurate statement is that the story of property is only partially told by the balance sheet, but we will come back to that in a moment.

## Contracts

Contracts represent the promise and agreements the company has made; its story is told by the income statement. The income statement represents the outcome of the contracts that have been completed with customers.

## Cash

Cash is king, right? Cash is perhaps, a business's most unique 'property'; and its story is told by the cash statement. There are four primary ways to get cash-debt capital (loans from banks or bond holders), equity capital (paid in cash by owners/stockholders), selling property (fixed assets or business units), and settlements of contracts (payments from customers). The creation (sales) and eventual settlement (getting paid) of contracts is by far the most important source of cash to your company.

## The Confusing Interrelation of Property, Cash, and Contracts

You can see by now that the overall story of a business, through its financial statements or through property, contracts, and cash can get complicated. And it is definitely interrelated. The news you probably do not want to hear is that most business people, including top decision makers, do not adequately understand this story. Hence, most of your people are only partially informed as to how their day-to-day decisions impact the most important measures of success.

## Why Should Anyone but the CFO or Accountant need to Understand our Balance Sheet?

It is ironic that a company's balance sheet does not mention (or value) what are usually the company's most important properties—the people. For example, how does it show the collective knowledge and teamwork of your managers and employees?

How does the balance sheet show the unique processes that have been developed, the patents and other intellectual properties developed over the life of the company? Last time I looked, the balance sheet left out the collective value of your company's relationships with customers and vendors. For many companies, these invisible intangibles have greater value than all of the company's tangible assets.

Before we can really paint a clear picture about what understanding your balance sheet and the intangibles will lead to, we need to do some more exploring.

## Understanding the Gap between Property and Real Value

Taking a look at sample public companies can help you understand the gap between the value of a company's property on the balance sheet and its real value including the intangibles—commonly referred to as the value of the 'brand.' Find any company balance sheet (easily found on Yahoo finance) and subtract 'Total Liabilities' from 'Total Assets,' which gives you the 'Total Equity' or the book value of the company. The table below shows the \*book value of four well-known corporations:

\*All values in 1,000's

Company	Book Value
Coca Cola	\$25,518,000
Proctor & Gamble	\$66,430,000
Dell	\$5,878,000
Caterpillar	\$9,272,000

Since these are public companies, the marketplace can give us a pretty good idea of the actual value of the company including all its intangibles. This number is referred to as the company's market capitalization which is calculated by multiplying the current stock price by the total number of outstanding shares. This number obviously changes every day and can be somewhat volatile, but it represents what the shareholders have determined is the true value of the company. The table below includes the \*market capitalization for these same companies.

\*All values in 1,000's

Company	Book Value	Market Capitalization
Coca Cola	\$25,518,000	\$128,700,000
P&G	\$66,430,000	\$177,690,000
Dell	\$5,878,000	\$23,520,000
Caterpillar	\$9,272,000	\$43,290,000

Dividing the market capitalization of Coca Cola by its book value indicates that the marketplace says that Coke is 5 times more valuable than its balance sheet indicates. These numbers are as of mid-August, 2010. If you wanted to own Coca Cola, it would cost you approximately \$129 Billion dollars to acquire it. This means that the company's managers and employees are making decisions for a company that is worth a lot more than the \$25 Billion dollar 'book value' of the company.

Determining these relative values can be more challenging for privately owned companies that do not have a public marketplace to value themselves, but the intangible value is still there.

## Every Decision can Impact Company Value

Whether public or private, what is the true value of your company? Based on that value, does it make sense that the people making decisions that can dramatically raise or lower that number do not know how those decisions are impacting the tangible and intangible property, contracts and cash? A clear example was recently stated by Mellody Hobson, President of Ariel Investments. Take BP she says, "lack of a \$500,000 valve took \$20 Billion of the company's market cap." You can be certain that the decisions concerning this oil spill incident were made in the field and not in the senior executive suite. How vulnerable is your company to similar uninformed decisions?

## What Can You Do?

If your company is 3 - 5 times more valuable than its book value, then every person's behaviors and choices have 3 to 5 times more leverage--positive or negative on strategic and financial results. It is a wise investment of your time to find out how well informed your people are about important financial principles and relationships. You can easily test for this knowledge.

Odds are you are going to find out that this knowledge is not widely understood, in which case you will need to select a way to train people in these skills and abilities. Regrettably, many companies believe that having someone from finance deliver a PowerPoint presentation about company finances will adequately inform people's decisions.

Such efforts usually fail to produce sustainable results. Remember the stakes here and also how confusing these principles are for many non-financial professionals. Selecting the right training program to meet your needs can be one of those behaviors that makes the difference in positively leveraging your company's financial results.

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## About Stratactics

Stratactics expertise is teaching finance to non-financial professionals who need to understand and use business strategy and financial principles to make better decisions. Our programs utilize experiential learning techniques to provide a comprehensive and practical approach to the fundamentals of finance, accounting, financial analysis and decision-making.

Darrell Mullis, author of *The Accounting Game*<sup>TM</sup>, founded Stratactics in 2001 out of his passion for making learning fun, engaging, and meaningful. Stratactics has successfully helped clients from all around the world, including Fortune 100 and 500 companies, to improve business acumen and communication at all levels of the organization.



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