'Moneyballing' a business

The same principles that led the Oakland A's to baseball success can set any business up to weather a crisis, writes **Jamie Townsend**

AFTER THE Oakland A's went up 2-0 in the 2001 postseason and then lost the series to the New York Yankees, the A's general manager, Billy Beane, knew he needed to do something. That something, as it turned out, was to ask new questions about how to properly value a player. This led Beane to place a higher importance on a player's on-base percentage, which in turn gave the A's, a team with one of the lowest payrolls in Major League Baseball, an early advantage no one else had. Michael Lewis wrote about this in his book, *Moneyball*, which was eventually adapted into a movie starring Brad Pitt.

Today, this same idea of using data to provide a fresh look at business is offering similar advantages to many business owners. Their ability to grow and protect their businesses has dramatically improved.

According to the Canadian Cancer Society, one in 2.2 men and one in 2.5 women will develop cancer in their lifetime. If that's true, what's the impact if those workers don't show up to work for eight or 12 months while battling the disease?

In the case of a real-life business we'll call ABC Company, it was greater than they expected. ABC Company is a second-generation manufacturing business that has experienced tremendous success. The owners, who are great at their particular craft, are looking to hire more staff and expand their facility. One of the founding shareholders (let's call him Bob) is still heavily involved in the day-to-day operations and continues to drive approximately 25% of total revenue. The other shareholders are working to transition Bob's existing relationships and purchase his shares in the business, but recognize that this is not an overnight process. They understand they would have significant exposure if Bob were not able to come to work each day.

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Worst case, if Bob did not show up to work for 12 months, the expected impact is a 25% decrease in sales and a reduced net cash position. However, over time, we would expect the business to adapt and sales begin to increase.

A closer look reveals that Bob's 12-month absence would create an accumulated cash loss of $1 million over the next five years. More surprising is that even after five years, the business runs the risk of not growing back to its original expectations.

ABC Company's ability to 'moneyball' their business helped them identify three major risks:

1) Bob's share purchase would need to be extended an additional three years and would result in $200,000 of additional interest costs. Not to mention, Bob would have to work almost three years longer than he planned to help the business facilitate buying out his shares.
2) To maintain positive cash flow and stay within their banking covenants, ABC Company would need to downsize two of their key project managers. These individuals represent many years of experience and would be hard to replicate in the future.
3) The building expansion they started would be at risk of becoming cash flow negative. The expansion was based on their original sales projections and did not account for a 25% decrease in total volume.

If we look at successful businesses of similar size, they typically spend 0.5% to 1% of their total revenue on insurance to protect the other 99.5%. ABC Company was spending 0%.

In this case, the company purchased a $1 million critical illness policy on Bob to provide coverage for one of 24 major diseases (the most common being heart attack, stroke or cancer). The intent was for the company to use this policy to stay in a similar cash flow position even if Bob got sick. Even if Bob is not able to come to work tomorrow due to a critical illness, the company can still continue buying Bob's shares and funding their facility expansion.

Additionally, they would have the ability to maintain their existing staff and even hire a new person to help cover off some of Bob's responsibilities. Ultimately, by the end of 2021, ABC Company's cash position would be similar to their original expectations, even though Bob was sick.

By 'moneyballing' their business, they were able to reveal insights about how their company worked and, most important, cover off major risks with only a minor cost to ensure they continue on their growth plan. WP

Jamie Townsend *works with business owners to help simplify their financial lives. Typically this involves finding ways to 'moneyball' their planning to achieve tax-efficient solutions for succession, retirement and estate planning problems.*