

SBU Concept of Business Structure and Management



Strategic Business Units or SBUs have been defined as autonomous divisions or organizational units, small enough to be flexible and large enough to exercise control over most of the factors affecting their long-term performance. They focus on product offering and market segment—having clear marketing plan, campaign and analysis. They have autonomous mission and objective. They inspire the owning empire to respond quickly to changing economic situations. The author has tried to explore the concept of business structure and management from the SBU perspective, while looking at different categories of SBUs, in this article. He has also discussed the management mechanism of the SBUs in details. Read on to understand this crucial perspective...



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What is an SBU?

As a company grows, it gradually adds new products (covers services also) to its basket of business. To start with, the new products are variants or derivatives of the original products, like an automobile company launching new models of cars. Later on, even products of different segment or industry are added, e.g. a heavy engineering company going for software business, etc. However, as the business grows, the management becomes complex and tough. New business divisions are created to ensure better operational efficiency. In the earlier days, the business efficiency of an individual

division was measured by the amount of turnover achieved by it. In a nutshell, it was a top line approach.



Profit-making companies were trying to add more and more products to their basket of business without giving much thought to the margin from each such new addition. However, with fierce competition after liberalisation and globalisation of economy coupled with limited resources for expansion, the profit from operation took the center stage. Consequently, turnover concept-based business division was transferred into an SBU (strategic business unit), which is a profit centre focusing comprehensively on product offering, market creation as well as profit from operation. Efficiency of an SBU is measured on profitability rather than turnover alone.

AS 17 – the Reflection of Performance

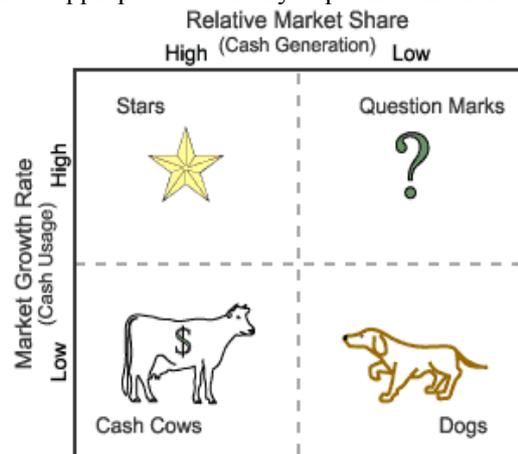
Accounting standard on segment reporting, i.e. AS 17, requires reporting of financial information about different types of products and services an enterprise provides, known as *primary reporting*. A business segment is a distinguishable component of an enterprise providing a product or service or group of products or services that is subject to risks and returns that are different from other business segments. A business segment is a reportable segment if (a) revenue from sales to external customers and transactions with other segments exceeds 10% of total revenue (both external and internal) of all segments; or (2) segment result, whether profit or loss is 10% or more of (i) combined result of all segments in profit or (ii) combined result of all segments in loss whichever is greater in absolute amount; or (c) segment assets are 10% or more of all the assets of all the segments. Under primary reporting, each reportable segment should disclose revenue—both external and internal, segment result, amount of segment assets and liabilities, cost of fixed assets acquired during the year, depreciation, amortisation and other non-cash expenses. A company can have more segments than the minimum mandatory requirements

A company can have more segments than the minimum mandatory requirements under AS 17. Like any financial reporting, the primary segment reporting under AS 17 is a reflection of performance of underlying divisions. However, for a discussion on the effective business management through SBU concept, we need to touch upon various other elements as attempted in this article.

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Categorization of SBU

BCG matrix developed by Bruce Henderson of Boston Consulting Group, USA, in 1970 is a popular tool for classifying various SBUs in an enterprise. This matrix has four cells with horizontal axis representing relative market share and the vertical axis denoting market growth rate. Resources are allocated to various SBUs according to their position on the grid. As displayed in the following figure, four cells of the matrix have been named as *cash cows*, *stars*, *question marks* and *dogs*. It will be appropriate to briefly explain each of the cells.



- *Cash cows* are units with high market share in a slow growth industry. These units typically generate cash in excess of the amount of cash needed to maintain the business. Each company would be interested to have as many SBUs as possible in this cell. Literally speaking, these SBUs are to be milked continuously with as little investment as possible.

- *Stars* represent business units having large market share in a fast growing industry. These units generate cash but because of fast growing market, they require high investment to maintain their position. Net cash flow is usually modest. SBUs located in this cell are attractive as they are located in a robust industry and at the same time these units face tough competition. If succeeded, a star SBU will become a cash cow unit when the industry matures.
- *Question marks* represent SBUs having relatively low market share in a high growth industry. They require huge investment to gain market share. Such SBUs need to be analysed to examine their business viability. Question marks are usually new products that have a good commercial prospective.
- *Dogs* represent business units having weak market share in low growth market. These units have weak market share because of high cost, poor quality, ineffective marketing, etc. Such units need to be avoided in an organisation, unless there is some convincing long-term prospect.

It may be noted that the BCG matrix is a tool to help broad categorisation of SBUs. Categorisation may vary from company to company. Each company has to arrive at the categorisation based on its perception about market conditions, future prospect of the industry, company's strategy to acquire market as well as availability of funds for investment. Anyway, for better understanding of the SBUs categorisation, let us take some illustrations from the published annual reports. As per the ITC Limited Annual Report, 2012, FMCG (Cigarettes) Division had a revenue of ₹22,250 crore with profit margin of 31%. This division's revenue share in total business of ITC is 58%. This business has a formidable market share of 72% with only 3 major players in the market, with no one touching 15% market share. This division's profit earning is 82% of total ITC profit. At the same time,

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Product and process innovation can happen either by in-house R&D activities or import of technology or both. However, the SBU Head should have the insatiable quest to make "Better than the Best" for the target customers. It may be in form of better product, novel product, simple-convenient-less expensive product etc. The ultimate success depends on 'performance – price point' that the competitors cannot match.

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the future growth of cigarettes market seems to be between low to moderate in view of social awareness about evil effects of tobacco, statutory restriction regarding smoking at public places as well as increased duty rate. Although there is good margin in this business, there is tremendous entry barrier due to huge investment and stringent statutory compliances. As such, ITC is expected to enjoy its formidable position in this segment of business and earn huge profits in coming years too, although it is not required to invest heavily in this segment. FMCG-(Cigarettes) SBU may be considered as cash cow of ITC. During the year, the company had incurred capital expenditure of ₹721 crore in Hotels Division and ₹594 crore in Paperboards, Paper and Packaging Division, which are the emerging segments. As per the author, these SBUs may be considered as Stars with future investment likely to be funded largely by FMCG (Cigarettes) business. Other 2 SBUs, viz. FMCG (Branded packaged foods, personal care products, stationery products, branded apparel, incense sticks and safety matches) Division and Agri Business Division are having revenue of ₹11,240 crore in aggregate with margin of just 4%. However, these SBUs may be perceived as Question Marks with expectation of high market growth in these segments in the coming days. As such, these businesses may be requiring huge investment for higher market share. Let's analyse the segment reporting of another diversified company, i.e. Titan Industries Limited. As per the Annual Report, 2012, two Divisions of the company, viz. Watches and Accessories Division and Jewellery Division had revenue of ₹1,520 crore and ₹6,990 crore respectively with respective profit margin of 14% and 10%. As per the author, these SBUs may be considered as Stars for the reasons of having good market share, operating in a fast growing market, however requiring high investment to maintain their position in the competitive market. Third SBU of Titan Industries, i.e. Eye Ware Division, may be considered as Question mark in view of relatively low market share in an industry with good commercial prospective. The company needs to examine closely the viability and growth of this SBU and invest accordingly.

Management Mechanism of SBUs

In a multi-SBU company, it requires proper categorisation of SBUs as well as prudent management of each SBU. In this context, a CFO plays a key role in extending necessary functional and advisory support to the individual SBU Heads, and functioning as an

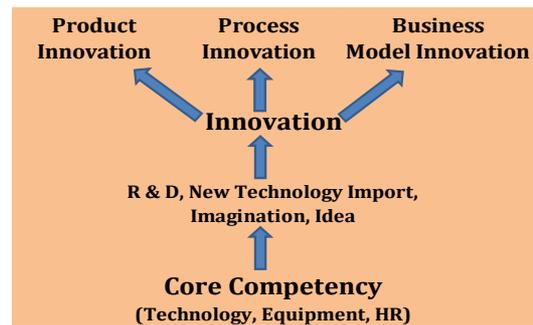
Although SBU managers are expected to be involved in strategic decision making, take calculated risk to achieve greater results, many a times there is a tendency to negotiate for manageable targets that appear to be imposing outwardly but are inwardly comfortable because of advantageous position of the SBU in the particular industry.

effective link with the CEO of the company. In order to make his role clearer, various elements of management mechanism of SBUs have been discussed below.

1. Hand Holding of Core Competency and Innovation

An SBU should try to improve upon its existing products as well as add on new products in order to increase revenue and profit. However, it depends on the innovative attitude and aptitude of the SBU. Many a times, core competency and innovation are considered paradoxical, which in fact is not correct. Core competency of a company acts like a power house of technologies, equipment and human resources for innovative efforts. Innovation can be of various types, viz. product innovation, process innovation and business model innovation. Product and process innovation can happen either by in-house R&D activities or import of technology or both. However, the SBU Head should have the insatiable quest to make “Better than the Best” for the target customers. It may be in the form of better product, novel product, simple-convenient-less expensive product etc. The ultimate success depends on ‘performance–price point’ that the competitors cannot match. Precision engineering is the core competency of Titan Industries. By blend of precision engineering and product innovation, the company has been able not only to add new model of watches, but also to introduce new products in the field of jewellery and eye ware segments, which have become independent SBUs. Tata Chemicals—the world’s second largest producer of soda ash, by process innovation, could filter the hazardous effluents created during production of soda ash and make raw material out of it which is required for production of cement. This has not only reduced the cost of effluent treatment but also given a new product, raw material for cement industry. Later on the company started producing cement taking advantage of in-house produced raw material and it became new division. Apple by introduction of novel and pioneer products in regular interval, e.g. iPod, iPhone, iPad, etc., has been

able to increase its product line successfully. In case of business model innovation, Flipkart may be referred to. It is an Indian e-commerce company offering multiple payment methods like credit card, debit card, net-banking, etc. However, the innovative business model of cash-on-delivery adopted by Flipkart has proven to be of great significance since the credit card and net banking penetration is very low in India. The outcome is amazing. Flipkart's reported sales which were ₹40 million in the financial year 2008-09, crossed ₹5 billion during 2011-12.



2. Creation of SBU by Strategy and not by Size

Although AS 17 requires segment reporting based on threshold limit, the company should create an SBU based on market size and growth of the product(s) falling in the division, positional advantage of the company for such products, margin from operation, etc. A product in a niche market may have substantial commercial prospect in future for which the company may exploit its positional advantage. If the product has different market dynamics, it is advisable to make a separate SBU for it. The profit centre concept will drive the SBU to gain expertise for commercial success soon. Fowler Westrup, a Bangalore-based MNC is engaged in the manufacture of various equipments for post-harvest applications in the agri segment. A few years ago, it introduced galvanised steel silos in Indian market which offer scientifically the best and safest solution for storage and handling of grains, cereals and other agri commodities. Although the product was generically falling in the agri segment, the company decided to have a separate SBU for silos, since the niche product had to face challenges and compete with the traditional storage method of gunnysacks in concrete and MS storage structures which is predominantly controlled by government sector. The market dynamics was quite different in comparison to other agri processing equipment. The decision of the company ensured focused approach and yielded affirmative result.

3. Performance Measurement

When a company migrates from a centralised to a decentralised organisational model, it encounters the problem of setting up targets and designing a reward system. Although SBU managers are expected to be involved in strategic decision making, take calculated risk to achieve greater results, many a times there is a tendency to negotiate for manageable targets that appear to be imposing outwardly but are inwardly comfortable because of advantageous position of the SBU in the particular industry. Top management should suitably use its power and influence in convincing the SBU managers for improving the performance and the resultant benefits both to the organisation and employees.

Performance Management



Targets should be well-defined, tough and challenging but achievable. A CFO has to play an important role in preparation of annual budget for various SBUs, the consolidation of which will be the corporate budget for the entire company. He should gather the information on sales forecast, purchase planning, manpower requirement, sales promotion, etc., from the SBU Head. He should collate it with the market size and growth pertaining to the SBU in order to examine the veracity of the sales forecast. In case of capex budget, he should examine the justification by ascertaining the return on investment (ROI) for the proposal. Finally, in consultation with the CEO, the CFO should prepare the SBU budget. For preparation of SBU-wise profit and loss statement, he should evolve a realistic norm of apportionment of common overhead expenses between the underlying SBUs. Every month, actual operating result of the SBU should be compared with the monthly budget and the variance should be analysed, which would help the SBU Head and the CEO for necessary corrective measures. As corporate finance is a centralised function, the CFO has to play a critical role in ensuring requisite funds for operation as well as for expansion of the SBUs. He should closely monitor the funds flow of each SBU and judiciously

channelise the surplus fund of one to another SBU having a shortage of fund.

4. Marketing Campaign: Think Differently

Each SBU should develop its own marketing strategy. *Star* category SBU needs to go for well-conceived brand building campaign for its product so as to conquer the confidence of the target customers. Company like Havells manufacturing circuit breakers, electrical wires, etc., (usually purchased through intermediary contractors) could win the confidence of household customers by well-designed and fascinating visual advertisements. It has now become number one in market share from earlier position of number three SBU in *question mark* dealing with niche product should aim to reach the target customers to know their needs, problems and psychological/cultural mindset. It must also find out what the competitors offer and whether there is any gap in the market which could be exploited gainfully. A CFO should examine such marketing campaign proposals with an open mind evaluating the prospective benefits, market study done by the SBU. He may rather try suitably to leverage expenses for such proposals against usual sales promotion expenses with relatively low value addition.

5. Financial Basics for Non-finance Executives

A CFO has the responsibility of enlightening the SBU heads and senior SBU managers about financial basics of business operation. He has to educate them about contribution from sales, operating profit, break even sales, management of working capital, return on investment (ROI) in case of capex proposal, ratio analysis, vendor negotiation for better commercial terms, negotiation of export documents under letter of credit, legal impact of critical clauses in commercial agreements, basic provisions of applicable indirect taxes, etc. Learning process should be simple, example-based, interactive and joyful.

6. Designing Reward System

There should be performance-based incentives to SBU managers based on their functionary role. The calculation mechanism should be linked to KRAs (key result areas). To bring more focus, an individual should have around 3-5 KRAs; each should be tough and challenging, measurable without ambiguity, unconditional and with a definite schedule for execution. Too many KRAs only dilute the focus on performance improvement and complicate the calculation process. KRAs should focus on results and not activities.

Although, the bulk of incentive, say 80%, should be linked to actual performance *vis-à-vis* KRAs fixed for the individual manager, a portion, say 20%, should also be linked to overall company performance, so as to bring collaborative attitude across the company. To bring more clarity, an illustration on reward system has been appended.

7. Effective Training and Career Planning

For the success of an SBU format of business organisation, the management should analyse training needs of the employees and address the issues accordingly. Better trained employees often lead to more satisfied and loyal customers and ultimately improved profitability and cash flow. There should be efforts to attract new talents and retain the existing talents. SBU concept creates a healthy and constructive competition among various divisions to excel better than the others. Further, a successful stint as an SBU head gives opportunity to assume higher responsibility in senior management echelon at a later stage. The CFO gains immense exposure in understanding the nuances of business strategies and coordinating with SBU heads for performance measurement and improvement. This exposure is likely to groom him to assume higher responsibility in general management of the company.

8. Challenges and Conclusion

In India, although there are plenty of qualified graduates in all fields of education, there is certainly dearth of competent manpower with thorough functional knowledge and managerial skill. In the SBU format of business organisation which is run on the principle of decentralised profit centres, the management has the challenge of identifying result-oriented SBU heads with extensive experience in the particular industry. Secondly, at the time of economic slowdown as well as liquidity crunch, the management usually becomes impatient towards newly set up SBUs in niche segment needing relatively longer gestation period before generating profit. Thirdly, organisation having SBUs should have good ERP package so as to ensure data accuracy and sound internal control. Lastly, SBUs should be run on the basis of strategy and not sentiment. There should not be emotional attachment to close down an SBU in case it proves to be commercially unviable. Anyway, it can be concluded that an SBU concept of business management is indispensable for a professionally managed company vying for rapid growth, however, with a strict watch on the investment and returns from each SBU.

Illustration of performance-based incentive calculation mechanism

KRAs of Mr. X, Manager (Marketing), Alpha Limited, working in SBU (ABC) for 2012-13

Sl No.	KRAs	Targets	Points for Actual Performance
1	Invoicing	₹500 crore	If less than or equal to 80%: 0 More than 80%, upto 90%: 20 More than 90%, upto 100%: 25 More than 100%: 30
2	Order Booking	₹750 crore	If less than or equal to 80%: 0 More than 80%, upto 90%: 20 More than 90%, upto 100%: 25 More than 100%: 30
3	Collection	Debtors Days: 30	Debtors Days equal to or exceeding 40: 0 Debtors Days exceeding 30, less than 40: 10 Debtors Days not exceeding 30: 20
4	Customer Base	Number of New Customers: 25	Not exceeding 15: 0 Exceeding 15 but less than 25: 05 Equal to or exceeding 25: 10

For 100% achievement in 4 KRAs, Mr. X will earn 80 points.

Mr. X can earn additional points for more than 100% performance in KRAs of invoicing and order booking.

Company Performance target of Alpha Limited for 2012-13.

- Company meets budgeted sales : 10 points
- Company meets budgeted profit: 10 points

Total: 20 points

For 100% achievement in individual KRAs and Company results, Mr. X will earn 100 points.

Incentive Calculation:

Mr. X will get incentive @ 30% of his total salary (CTC) for earning 100 points, to be adjusted upward / downward as per actual points earned. ■