Identifying Potential Client Companies

Overtrading/PBWC, Performance Drag, and its Quantum: The three building blocks for identifying a Potential-Client-Company (PCC) – an addendum to the Commercial Framework Value Proposition and the Double Disconnect analytical notes

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Three analytical building blocks underpin the identification of a Potential-Client-Company. Each is necessary. None is sufficient alone. This addendum defines each building block precisely, establishes the relationship between them, and explains why the framework requires all three to be present simultaneously before a company qualifies.

1. OVERTRADING AND PBWC

Overtrading

Overtrading describes a condition in which a business is generating turnover at a level its financial structure cannot support – trading beyond its capital base. The characteristic presentation is a business that is growing or sustaining turnover while its working capital position deteriorates, its breakeven rises, and its profitability compresses. The business appears operationally active. Its financial position is progressively weakening.

Overtrading is common. It arises from rapid growth, poor financial management, undercapitalisation, aggressive pricing, extended debtor terms, and a range of other ordinary commercial conditions. It is not, of itself, diagnostic of anything beyond a mismatch between commercial activity and financial resource.

PBWC – a specific form of overtrading

PBWC – the Profitability–Breakeven–Working Capital dynamic – is a specific form of overtrading with a specific cause. It arises when a business secures contracts through access payments – the informal payments made to Contract-Controllers – the individuals with authority over contract award, whether in a government body, a state-owned enterprise, or a private company – to purchase the right to bid and deliver, rather than through competitive capability. The access payment extracts margin at contract level. That extraction simultaneously suppresses profitability, forces breakeven higher as the cost base must be sustained from compressed margins, and generates demand for additional working capital as the business is pushed toward larger and longer contracts to cover its rising cost floor.

The three effects – profitability falling, breakeven rising, working capital tightening – operate simultaneously and compound across operating cycles. They do not resolve through the management responses the formal business model generates, because those responses address the financial symptoms without reaching the commercial cause.

Common overtrading can produce adverse movement in all three factors simultaneously – a rapidly scaling business with compressed margins, an expanding cost base, and extended debtor terms may exhibit the full PBWC pattern without any access payment in sight. The diagnostic distinction is, therefore, found in the matter of cause. In common overtrading, the three factors move adversely for different, separable reasons. Each can be addressed individually: tighten debtor terms, restructure the cost base, inject equity. In PBWC, all three factors move adversely for the same reason – the access payment operating at contract level. Addressing any one factor individually does not resolve the dynamic. The cause persists, and it drives all three factors back. The compound simultaneous movement is the fingerprint. The single-cause explanation is where its diagnostic power lies.

Why overtrading alone does not qualify a PCC

Overtrading is not exclusive to the Buy-the-Business Model (BTB Model). A company exhibiting the financial characteristics of overtrading may be doing so for reasons entirely unconnected to access payments. The presence of overtrading, or even of the specific PBWC financial fingerprint, is therefore a necessary but not sufficient condition for PCC identification. It directs analytical attention. It does not conclude the analysis.

2. PERFORMANCE DRAG

What Performance Drag is

Performance Drag – PD – is an existing and observable shortfall in a company's performance relative to one or more reference points. Those reference points are: the performance metrics of the Group or Region in whose portfolio the company sits; the performance metrics of the industry or sector in which the company operates; and the performance of the broader country economy. A company exhibiting Performance Drag is underperforming against at least one of these reference points in a manner that is recognisable and cognisable in operational terms.

Performance Drag is the second building block because it establishes that the PBWC fingerprint is producing a real and measurable shortfall – not merely a financial pattern that could be explained by ordinary commercial conditions. The drag is the evidence that something is extracting value from the business in a way that is visible at the level of its operating performance relative to peers and context.

What Performance Drag is not

Performance Drag is not a financial loss in the conventional sense – an identified cost or write-down that can be reversed once its cause is removed. Nor is it simply an opportunity cost – a recoverable gap that closes when the BTB arrangement ends and normal commercial activity resumes.

The word drag is deliberate. The PBWC dynamic, operating over time, shapes the business – its contract portfolio, its cost structure, its commercial relationships, its working capital requirements. Removing the BTB input does not restore the prior output. The parts that remain do not return predictably to their pre-BTB behaviour. The drag describes the existing performance shortfall in the existing model. What happens after the BTB arrangement ends is a separate and genuinely uncertain question. The framework makes no assumption about recovery trajectory.

3. THE QUANTUM OF PERFORMANCE DRAG

From recognition to measurement

Performance Drag is recognisable and cognisable in operational terms before it is quantifiable in financial terms. The operational evidence – PBWC fingerprint distinctive to this company, underperformance relative to Group, sector, and country reference points – is what establishes that the drag exists. The quantum is what puts a financial value on it.

The Quantum of Performance Drag – QPD – is required because the Capital Allocation (CA) function, in whatever form it operates within the business, makes capital allocation decisions in financial terms. A drag that cannot be expressed financially cannot be acted on. The QPD translates a recognisable operational condition into the language in which the capital allocation decision is made.

ROIC minus WACC

The QPD is expressed as the spread between Return on Invested Capital and the Weighted Average Cost of Capital: ROIC minus WACC.

Where WACC exceeds ROIC, the business is destroying value. Every unit of capital deployed in the business is returning less than the cost of deploying it. The spread is the rate of value destruction per unit of capital employed. That is the quantum of the Performance Drag expressed in the terms the capital allocation decision is already being made in.

Where ROIC exceeds WACC, the business is adding value. A company in this position does not exhibit a Performance Drag in financial terms, regardless of what its operational record shows. The financial quantum is not present. It does not qualify on this criterion.

Why this metric

ROIC minus WACC is widely understood and requires no proprietary methodology to explain or defend. It is the standard instrument through which the CA function – whether that is a dedicated capital allocation management team or, as is more common in the companies SSC engages, a financial control or business development function carrying the CA responsibility – already evaluates the performance of capital deployed in the business. The QPD does not ask the CA function to adopt a new analytical framework. It asks it to look at a spread it already tracks and consider whether the mechanism producing it has been correctly identified.

4. THE THREE BUILDING BLOCKS TOGETHER

A Potential-Client-Company is identified when all three building blocks are present simultaneously.

The PBWC fingerprint establishes that the financial and operational record is consistent with the BTB model in operation – and that the pattern is distinctive to this company, not shared by comparable businesses in the same Group, sector, or market. Overtrading alone does not establish this. The PBWC fingerprint, distinctive to this company against its reference points, does.

Performance Drag establishes that the PBWC fingerprint is producing a real and observable shortfall – that the company is underperforming against Group, sector, or country reference points in a way that is recognisable in operational terms. The drag is not assumed from the fingerprint. It is identified independently.

The Quantum of Performance Drag establishes that the shortfall is destroying value in financial terms – that WACC exceeds ROIC and that the spread is the financial expression of what the operational evidence has already identified. The QPD is what converts an analytical finding into a commercial proposition.

Each building block is necessary. None is sufficient. The framework requires all three because each does a specific job the others cannot do – and because the combination, when all three are present, eliminates the explanations the CA function will otherwise apply to its own analysis of the company's underperformance.