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INSIDE THIS ISSUE:

Smile Time

A priest, a doctor, and an engineer were waiting one morning for a particularly slow group of golfers. The engineer fumed, "What's with those guys? We must have been waiting for fifteen minutes!"

The doctor chimed in, "I don't know, but I've never seen such inept golf!"

The priest said, "Here comes the green-keeper. Let's have a word with him."

He said, "Hello George, what's wrong with that group ahead of us? They're rather slow, aren't they?"

The green-keeper replied, "Oh, yes. That's a group of blind firemen. They lost their sight saving our clubhouse from a fire last year, so we always let them play for free anytime."

The group fell silent for a moment.

The priest said, "That's so sad. I think I will say a special prayer for them tonight."

The doctor said, "Good idea. I'm going to contact my ophthalmologist colleague and see if there's anything he can do for them."

The engineer said, "Why can't they play at night?"

NPV and Utility Rate Making

Debunking Three Popular Myths

For his entire career, The Biz Bucks Guy has heard otherwise smart people say crazy things about how a utility operates and makes money. Although The Biz Bucks Guy was not as well versed as he is today, even when he was unaware of the details, these myths just didn't feel right.

Myth #1: We make money by spending capital. So our company wants us to develop as many capital projects as possible.

Consider this real life example regarding Myth #1:

From a Power Plant Engineering Manager: "At our power plant, we know we will get any amount of capital that we can think up because our company makes money by spending capital."

Myth #2: We make money by spending capital. Thus, if we can fix a problem with capital or with a one-time increase in O&M, we should always spend the capital and forget the O&M solution, no matter how cheap the O&M solution is or how expensive the capital solution is.

Consider this real life example regarding Myth #2:

The Biz Bucks Guy once had a client that sold brackets to extend the life of wooden poles. Their sales people were constantly frustrated when Distribution Asset Managers would say. "We don't want your simple, inexpensive solution that hits our O&M budget. We make money by spending capital. We will forgo your product and replace the aging poles, at substantially more cost because we make money spending capital."

Neither myth is correct. Both use what The Biz Bucks Guy calls "The Tyranny of Raw Dollars." When someone uses raw dollars to make a capital decision bad things happen. Consider a simple income statement for two firms. In the first, the company made last year $18 million. For the second, $15 million. Which one had the better year?

Answer: You don't have enough information to know.

Why? Because the raw profit dollars needs to be compared to the amount of invested dollars it took to make those profit dollars. If the first company's investors had ponied up $100 million to make $18 million, their Return on Equity is 18%. If the second company only ponied up $50 million to make their $15 million, their ROE is 30%.

Now which one had the better year? Clearly, the second company did better on behalf of the shareholders.

Let's extend this to profits of a utility. To do so, let's use the theory of perfect rate making. At the end of each month, the price regulator does a calculation , has a hearing, and poof, rates are quickly adjusted to reflect any changes in O&M

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A Biz Bucks Guy Opinion

What's a Luddite?

Over the years, The Biz Bucks Guy has read the term Luddite many times, but was too lazy to look it up. On March 27, 2017, Andy Kessler who wrote *Eat People* educated The Biz Bucks Guy on this term. According to legend from the Nottingham (England) Review newspaper, there was this English bloke, Ned Ludd, who allegedly broke up some weaving machines, near his home in Leicester, England. The apocryphal Ludd was protesting the labor saving devices because it put weavers out of work. Ludd, if he really existed, became a folk hero to some and eventually anyone who complains about technological progress is deemed a Luddite.

Now we have a very rich Luddite, according to Kessler. It's none other than Bill Gates, of Microsoft fame.

Recently, in Bejing, Gates was asked about the advent of robots. He responded with an

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> *"PEESTI is a system to assess the present and to apply the age old process of SWOT…"*

Leadership Readiness Skill #1

The Biz Bucks Guy hasn't mentioned PEESTI for some time on these pages. Let's take a look at this tool for assessing where you are today. PEESTI is a tool for Strategic Planning, the first of the twelve skills of leadership readiness. Once you have envisioned the future, called Future First Thinking, you must compare that vision to the present to find the gaps and to plan initiatives to close the gaps.

PEESTI is a system to assess the present and to apply the age old process of SWOT (sorry, another acronym to explain the first acronym). SWOT is Strengths, Weaknesses, Opportunities and Threats.

PEESTI stands for:

P = Political

E = Economic

E = Environmental

S = Social

T = Technological

I = International

The PEESTI tool is best used by assigning strategic planning sub-teams to each of the six items and then having them present their findings to the larger strategic planning group. By considering SWOT for each of the six items, an assessment of the present state of the organization emerges. Strengths and Weaknesses are an internal assessment. Opportunities and Threats are an external assessment.

Figure 3 - Twelve Skills of Leadership Readiness

Each Leader should strive to master processes, tools, and principles of:	Each leader should strive to master the behavioral skills of:
1. Strategic Planning and Implementation	7. Developing People
2. Customer Focus	8. Decision Making
3. Quantoidal Smarts of Finance, Accounting, and Statistics	9. Communications
4. Organizational Smarts	10. Delegating
5. Managing Work: Processes and Projects	11. Team Building
6.Managing Individual Performance	12. Leading Change

PEESTI provides a detailed analysis to provide organizational interventions to close the gaps that come from comparing the future to the present.

More on Luddites continued from Page 1

> *"How many secretaries, tax accountants, and typesetters did Gates put out of business?"*

amazingly Luddite answer. Gates promotes some sort of tax on robots! You see, according to Bill, robot won't pay taxes, thus we need to tax their owners to keep our federal fisc from dropping (the benefit of which would be another decent argument).

Kessler asks Gates rhetorically, then why shouldn't we tax Excel spreadsheets? How many secretaries, tax accountants, and typesetters did Gates put out of business? What Gates forgets is that technology has developed more and higher paying jobs. To quote Kessler, "Mr. Gates may be worth $86 billion—who's counting?—but the rest of the world made multiples of his fortune using his tools. Society as a whole is better off. In August 1981, when Microsoft's operating system first began to ship, U.S. employment stood at 91 million jobs. The economy has since added 53 million jobs, outpacing the rate of population growth.

Even better, the Third World is rising out of poverty because of improved logistics from personal computers and servers. This has dramatically lowered the cost of basic food, energy and health care. None of this happens without productive tools—doing more with less.

"What's most disturbing is that the Luddites never totally went away. How many times have we been subject to proposals that would tax progress? ObamaCare's regulations froze the medical industry. Its 2.3% medical-device tax was even worse, discouraging investment in one of the few innovative health-care sectors. Mileage standards on automobiles were a waste of resources contributing to the moronic Detroit bailout in 2009. Even a carbon tax is Luddite, raising the cost of energy to slow its consumption."

Maybe Gates would have been better off if he had finished his degree at Harvard, taking a few Hayekian econ courses along the way.

Luddites belong in the 18th century.

FROM *LEADERSHIP FOR THE RECOVERING QUANTOID*
THE BIZ BUCKS STRATEGY CYCLE

The following is taken from Chapter 4 of Leadership for the Recovering Quantoid.

Based on his MBA education and several consulting experiences, The Biz Bucks Guy has synthesized a model for strategic planning (see figure 6). The cycle is similar to the Deming cycle of plan-do-check-act. The strategy development oval represents *plan*. Strategy implementation represents *do, check*, and *act*, respectively.

Much of this chapter is focused on the strategy development. This however is a small percent of the collective effort of an organization using this cycle. Experience, education, and peer discussions support the notion that strategy implementation, not its development, is, many times over, the more difficult of the two phases. Organizations, particularly corporate settings, will want to use this cycle on an annual basis. After the initial cycle, unless there is radical change needed, updating the strategy should be less of an effort. Strategy development is the *heart* of the strategy cycle. Strategy implementation is the *art* of the cycle.

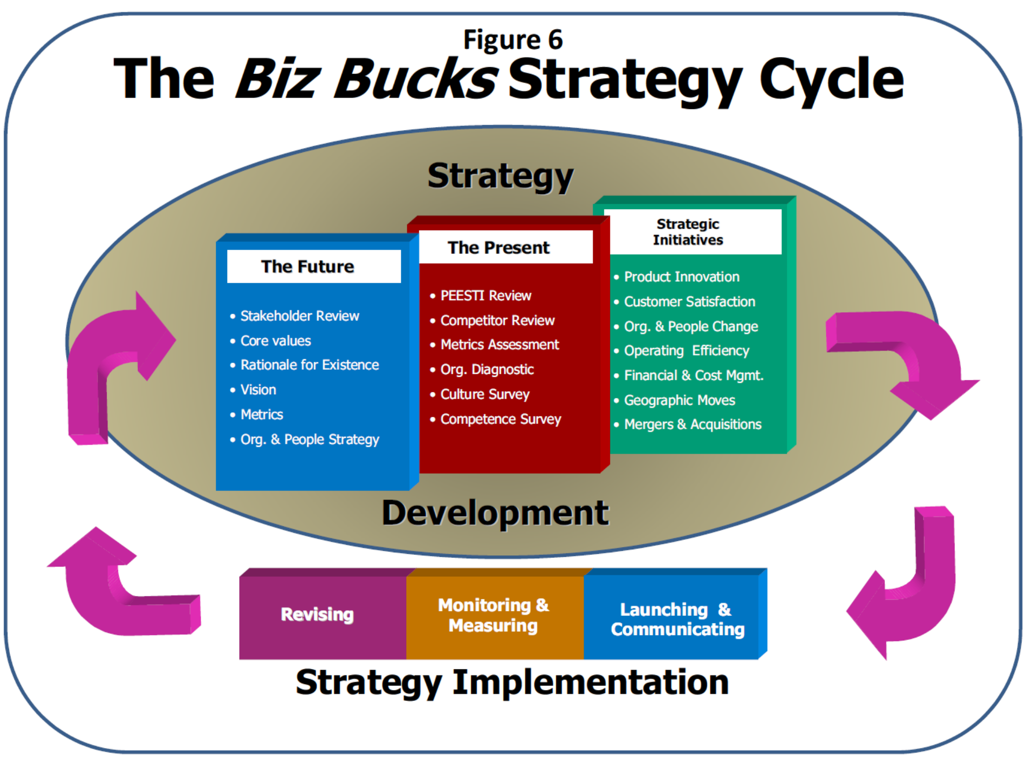
Using the model assumes a planning team has been formed of key people. If this is a corporate use, the CEO is the lead. Her direct reports are included. Perhaps a communication specialist is also added and selected others invited. An experienced facilitator is also needed. Each team member will have substantial homework between team meetings. This eventually means the results of the strategic plan are owned by the team. This is *not* a process where a high-powered consultancy is contracted to produce the plan and give it to the company executive team. That is rarely as successful as determining direction with an internal planning team.

Using the model will take several team meetings. Some steps of the model may require certain financial expenditures.

If you are an executive and believe this commitment of time, energy, and fortune is not possible for you, perhaps a demotion is advisable. Strategic planning and implementation is the essence of any executive role. If you shun strategy work, what part of leadership *do* you want to do?

Forming this planning team relates to the second of the four steps of leadership developed in chapter 1—build a small team.

"Strategic planning and implementation is the essence of any executive role. If you shun strategy work, what part of leadership do you want to do?"



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We're on the web at BizBasicsOnline.com!

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The Biz Bucks Guy has now taught or facilitated business-acumen and related principles to 5934 participants (thru December 2016)!

BIZBasics ONLINE

The BBO Quarterly *is published quarterly (surprise) by Bob Llewellyn, the "Biz, Bucks Guy" 1) to support past participants in BizBasics Online.com or "Biz Bucks" live training, allowing them to review the principles taught; 2) to possibly entice other unsuspecting victims into the class room or the online learning experience…and 3) to give the Biz, Bucks Guy something to do between gigs.*

BizBasics Online offers a quick, affordable, and effective way to gain the quantitative skills of business, being statistics, accounting, finance, and economics. BBO courses teach the BBO Decision Making Methodology for improved decision making.

One popular "live" course is Biz, Bucks & Blastoff, *a two-day course in financial decision making. This course is designed for engineers and other technical professionals who make or recommend financial decisions.*

Three Myths

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expense and capital projects placed in service.

Let's assume the price regulator and the company have agreed on a 10% Rate of Return (ROR) for capital.

If this month the utility installed a $10 million capital project how much would the net income increase? The regulator would provide an increase in rates that would equal an after-tax profit increase of $1 million. Yes, the utility's net income statement would grow by $ 1 million. However, how much ROE is that? 10%. That is exactly the ROR the commission allows. No matter how many projects the company does, their ROR is the same 10%. Welcome to the world of natural monopolies. We can only make an allowed rate of return or less. There is no real benefit to the shareholders. They knew they were investing in a utility. They liked the 10% return.

So Myths 1 & 2 are bunk. The company will only make the allowed rate of return no matter how many capital dollars are spent. For Myth #2, only a detailed Net Present Value analysis will determine whether it is best to use the O&M expense or the capital solution.

Now consider a third myth.

Net Present Value (NPV) is a tool taught in all good business schools for making financial decisions. As taught, NPV is increased value to the shareholders. It is not a customer perspective. Therefore, as Myth #3 goes, we should not use NPV to value our capital projects. We are duty bound to do what's best for customers, as a regulated utility. Well, that part is true, but NPV also acts on behalf of the customers in a utility.

Consider a capital project that has a positive NPV of $1,183,000. How is the customer benefited?

Assume the project cost is $5 million and provides an after-tax savings to heat rate of $ 1million each year for ten years. Using a 10% ROR as the discount rate, the NPV is $1,183,000. With this NPV, the Internal Rate of Return is 15%.

However, assuming perfect (monthly) rate making, the price regulator only allows an internal rate of return of 10%, so the profits are not allowed to increase as much as if it were an normal, non-regulated business.

See the Solution spreadsheet.

The Biz Bucks Guy has perturbed the savings and learned the allowed after tax savings is $807,000. The remaining $193,000 flows to the customer. In pre-tax terms, the savings is $321,000 and is reflected in lower revenues and rates.

Thus, NPV is a viable tool for electric utilities to use to value projects. The positive NPV amounts accrue to the customer.