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Enterprise Viability & Sustainability Diagnostic Toolkit

Understand Current Performance | Enterprise Classification

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Enterprise Viability & Sustainability Diagnostic Toolkit Modules

1. **Preliminary research**
2. **Understand current performance**
3. **Identify factors to improve viability**
4. **Assess sustainability**

Analytical activities

Enterprise Mapping

Select diverse enterprises based on their market context and sales performance for in-depth research

Exploratory Research

Understand enterprises' contexts and operations to customize tools and research questionnaires

Profit & Loss Statement Preparation

Prepare profit & loss (P&L) statements with revenues, costs, and resulting profits to support analyses

Profit & Loss Statement Analysis

Analyze P&L statements using financial ratios to enable inter-enterprise comparisons

Enterprise Classification

Categorize enterprise based on revenue and profit

Gross Margin Variance analysis

Identify the profit drivers that differentiate performance among enterprise categories

Strategy Identification

Identify the strategies that improve profit of enterprises in different contexts

Financial Independence Assessment

Assess enterprises' ability to meet recurring future financial investments independently

Operational Independence Assessment

Assess enterprises' ability to operate independently in future market conditions

Return on Capital Employed Analysis

Compute returns from sanitation relative to other opportunities available to the entrepreneur

Focus of this document

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- Introduction
- Selecting segmentation values for cash net profits
- Selecting segmentation values for revenues
- Mapping enterprises to different categories

Objective of this document

Intended outcome

This document is intended to help MBS programs understand a method for categorizing sanitation enterprises using their cash net profits and revenues and inform the next module, i.e.,"*Identify factors to improve viability*" module of this toolkit

Value for MBS programs

- Understand the distribution of enterprises based on their performance as per benchmarks / KPIs chosen by an MBS program
- Enables **comparison of relatively higher profit** enterprises with **lower profit** enterprises to identify the factors that distinguish their performance (next activity - *Module 3: Gross Margin Variance Analysis*) and identify profit improvement strategies (next activity - *Module 3: Strategy Identification*)

Note: The methods in this document are intended to offer practitioners with guidance rather than a strict model to follow. Practitioners are encouraged to adapt the methods or consider other approaches for their contexts.

Enterprise Classification – Process

Enterprises can be classified based on two dimensions that influence their viability – their cash net profits and their revenues.

Classification based on cash net profits allows the study of differences between relatively higher profit and relatively lower profit enterprises.

Classifying based on revenues allows the study of differences between higher profit enterprises at different levels of <u>scale</u>.

Enterprise classification

Cash net profit	Revenue
Measures the profits realized by an entrepreneur after accounting for all cash expenses	*Measures the scale of an enterprise*

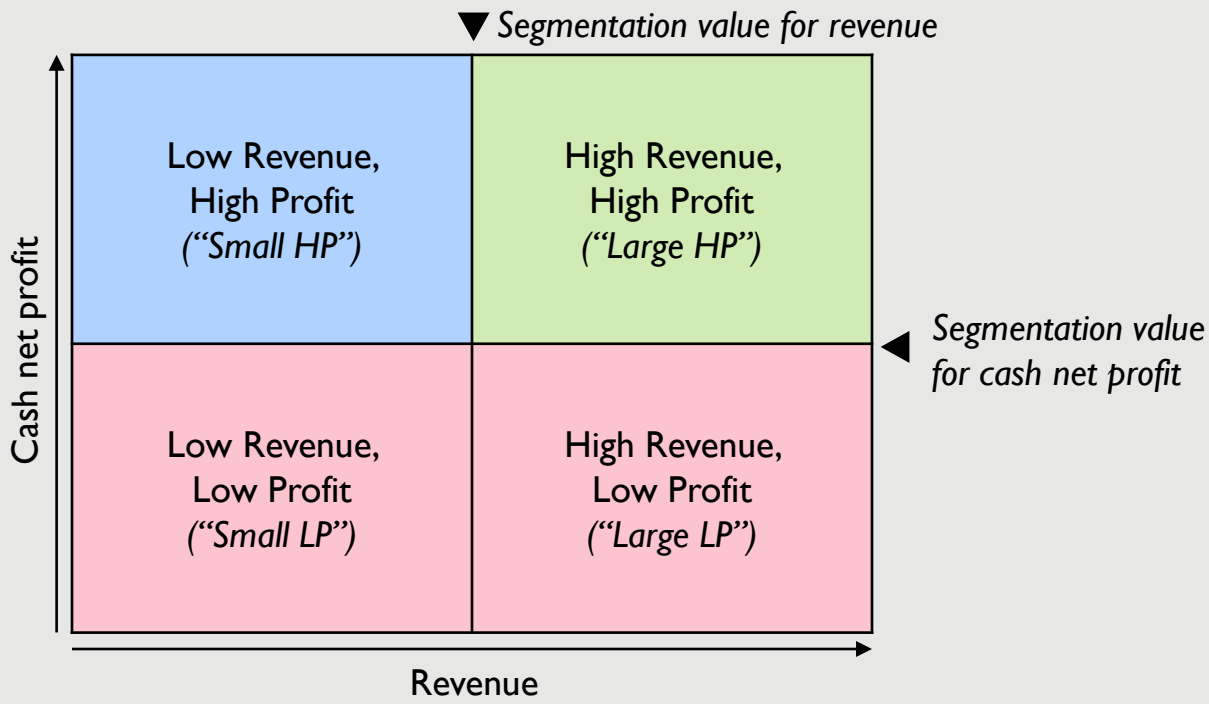
Tip

Refer to the document *Profit and Loss Statement Preparation* (part of the *Understand Current Performance* module) for further details on "cash net profits" and "revenues."

Enterprise Classification – Process

Enterprises can be relatively categorized as "high" and "low" on the two dimensions using appropriate segmentation values.

This leads to four possible categories into which enterprises can fall.

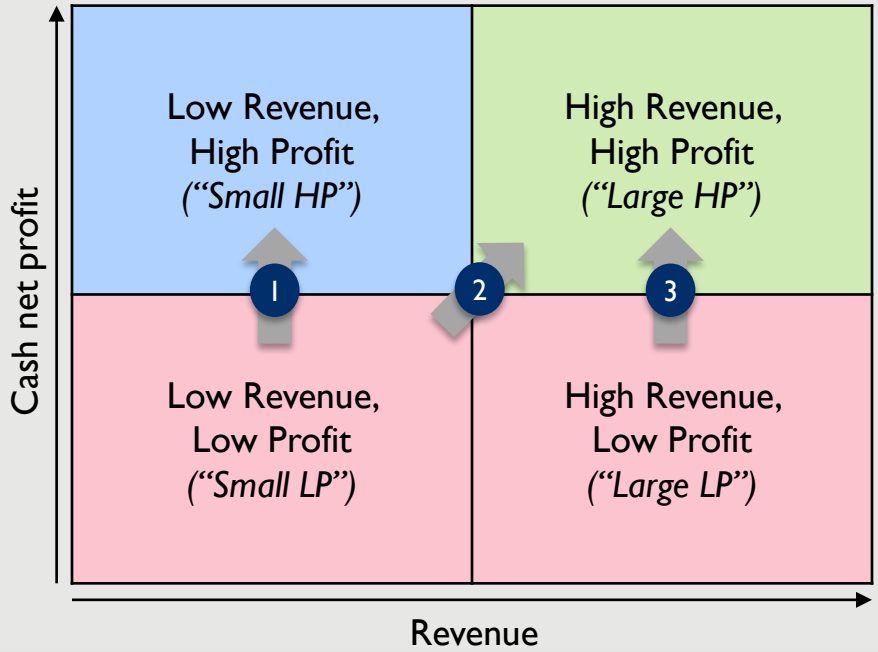


Tip The choice of segmentation values is subjective. While we suggest a few options in this document, MBS programs can choose any segmentation values as long as they meet the objective of identifying enterprises that are sufficiently different from each other in terms of performance.

Enterprise Classification – Process

By classifying enterprises using revenues and cash net profits, MBS programs can identify and compare enterprises that are sufficiently different in terms of their performance. This enables identification of factors that differentiate performance of enterprises. Specifically, MBS programs can compare enterprises from the following categories:

- **"Small LP" and "Small HP"**
- **"Small LP" and "Large HP"**
- **"Large LP" and "Large HP"**



Tip The "Large LP" and "Small HP" comparison is not specified since our experience interviewing entrepreneurs suggests that they would typically be reluctant to sacrifice sales (and hence revenue) to improve profitability.

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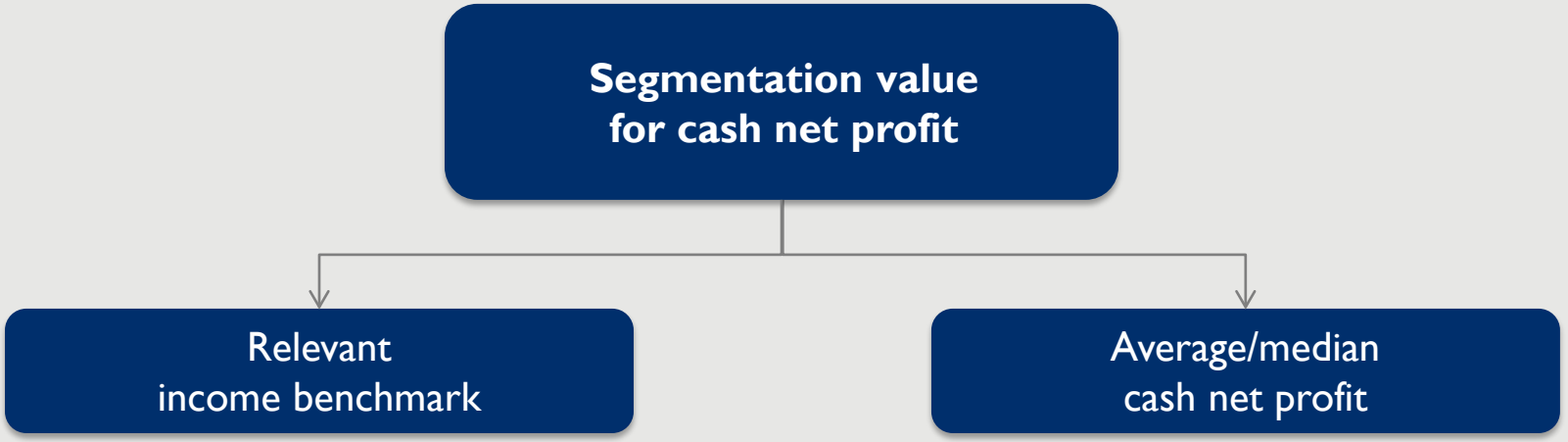
Selecting segmentation value for cash net profits

The segmentation value for cash net profits can be determined by choosing a relevant income benchmark or by using the average / median cash net profits of enterprises.



Recommended when cash net profits of enterprises are distributed adequately above and below income benchmarks

Appropriate when cash net profits of most or all enterprises fall either above or below income benchmarks

Relevant income benchmark as segmentation value

The income benchmark chosen to categorize enterprises should be considered locally relevant and reasonable for enterprises' contexts. The benchmark can be a macroeconomic indicator or an alternative locally available occupation from the entrepreneur's perspective.

Enterprise with cash net profits more than or less than the income benchmark can be categorized as "high profit" or "low profit," respectively.

"Low profit" enterprises < Relevant income benchmark **< "High profit" enterprises**

GDP per capita	Average annual household income	Average annual wage of a construction worker
Represents the economic output per person per year	*Represents the average household income per year*	*Represents the average annual income of a construction worker*

Example macroeconomic benchmark

Example alternative occupation benchmark

Tip

- The above benchmarks are meant to serve as examples. MBS programs can choose any income benchmark that is locally appropriate and has data available for their contexts.
- The income benchmark should be considered for the geographic unit where enterprises operate. For example, if all enterprises operate in the same district, district-level benchmarks should be used.

Average/median cash net profit as segmentation value

If most (or all) enterprises fall either above or below the income benchmark, then the average or median cash net profit of enterprises can used as the segmentation value.

Enterprise with cash net profits more or less than the average/median can be categorized as "high profit" or "low profit," respectively.

"Low profit" enterprises < Average/median cash net profit **< "High profit" enterprises**

Average cash net profit

Recommended when a few enterprises have cash net profits significantly greater than the rest

Or

Median cash net profit

Recommended when cash net profits are distributed relatively evenly between enterprises

Tip

MBS programs need to make a subjective judgement on whether to use average or median. The median value will always split enterprises into equal groups. If such a grouping is broadly reflective of the difference in performance between enterprises, then using median is appropriate.

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Selecting segmentation value for revenues

The segmentation value for revenues can be determined by using the average or median revenues of enterprises, similar to using average or median cash net profits (as described in the previous section).

Segmentation value for revenue

"Low profit" enterprises < Average/median revenue **< "High profit" enterprises**

Average revenue

Recommended when a few enterprises have revenues significantly greater than the rest

Or

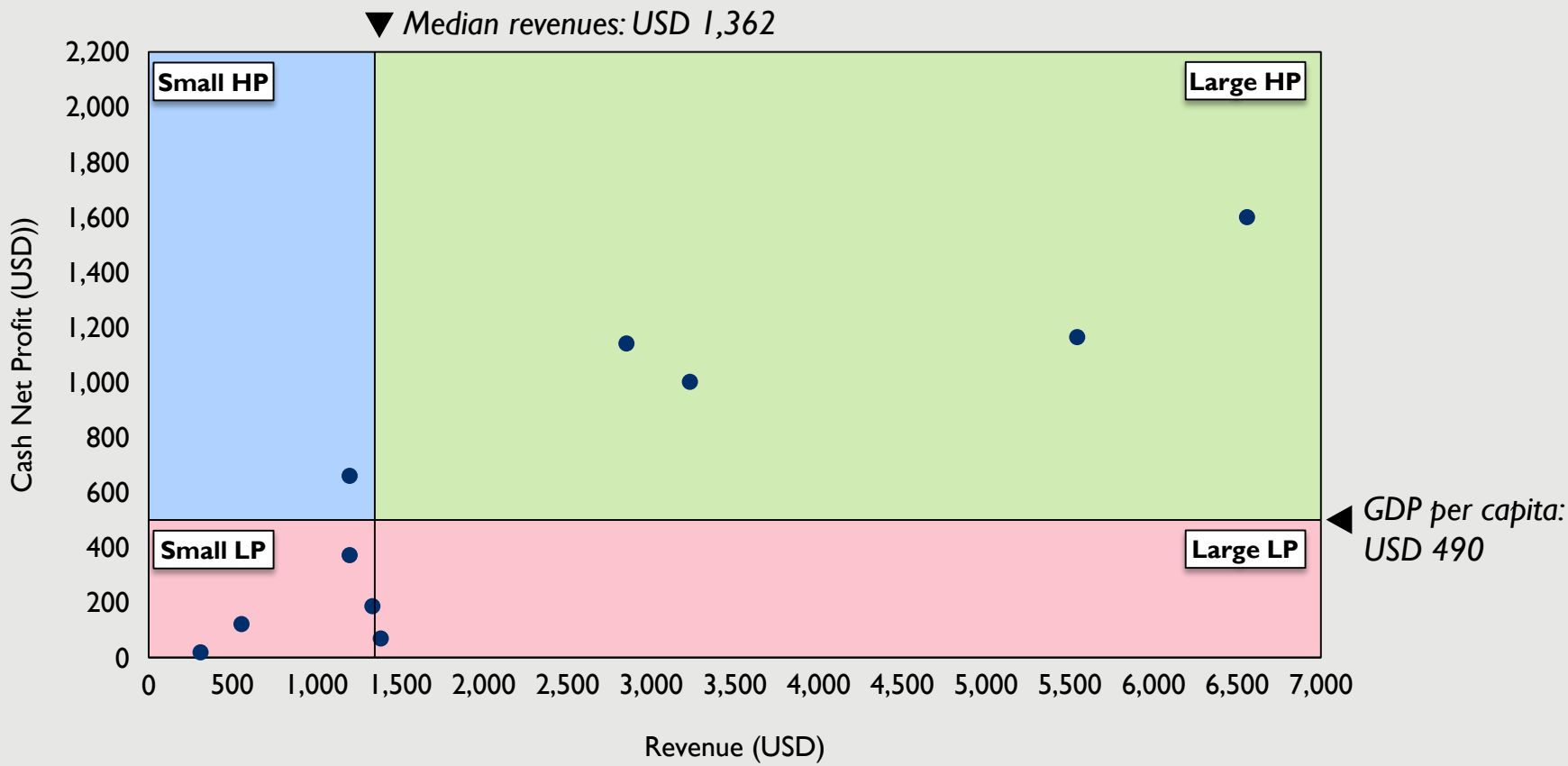
Median revenue

Recommended when revenues are distributed relatively evenly between enterprises

Tip

MBS programs need to make a subjective judgement on whether to use average or median. The median value will always split enterprises into equal groups. If such a grouping is broadly reflective of the difference in performance between enterprises, then using median is appropriate.

Enterprise Classification – Example

The below example classifies 10 enterprises into the four categories using the following segmentation values:

- **Median value (USD 1,362) for revenues**
- **GDP per capita (USD 490) for cash net profits**