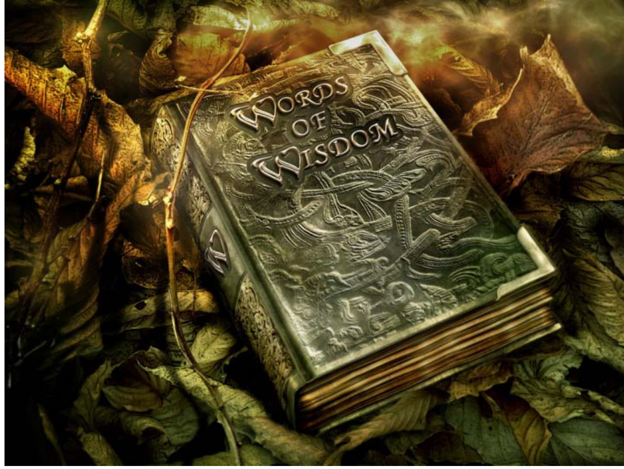


Words of Wisdom by Máté Molnár

Recovering & Building Value: Turnaround Management, Outside Director, & Distressed Investing Strategies

A Compendium of Articles
By John M. Collard

Contact:
John M. Collard, Chairman
Strategic Management Partners, Inc.
522 Horn Point Drive
Annapolis, Maryland 21403 USA
www.StrategicMgtPartners.com
John@StrategicMgtPartners.com
(410) 263-9100

Introduction

This collection of writings by John M. Collard is complied as a representative reference resource of strategies to be successful in the turnaround management, rebuilding value, and distressed investing industry. These articles have been published in many industry publications and demonstrate the thinking of John M. Collard, an expert turn around manager who runs troubled companies as their CEO, serves as outside director, advises boards of directors, lenders, lawyers, and private equity investors. There is a turn around process which involves bringing leadership, setting strategy, building a quality management team, acquiring new business/sales, establishing sound capital structure, implementing processes, and nurturing resources. Distressed company leadership is about value preservation, recovery, communicating with multiple stakeholders, rebuilding, saving jobs, and leading in adversity.

Enjoy.

Table of Contents

Turnaround Process: Phases and Actions Plan To Improve Success

Managing Turnarounds Requires Clear Thinking, Quick Action, and a Plan … 5
RMA Journal, Publication of the Risk Management Association (Commercial Bankers)

Managing Turnarounds: Phases and Actions To Accelerate the Recovery Process … 9
Directorship, The Magazine of The National Association Of Corporate Directors

Working With Turnaround Professionals To Preserve Value

Recover & Preserve Value: Working Successfully With Turnaround Professionals … 11
Part 1, When is Turnaround Specialist needed? Part 2, How Specialist operates
ABF Journal, Turnaround Corner (Asset Based Lenders)

Early Warning Signs of Companies Heading For Trouble

Deathbed Businesses: When a Business Stops Growing. It Starts Dying. … 20
Baltimore & Washington ***Smart CEO Magazines***

Is Your Company In Trouble? … 22
The ***Corporate Board Magazine***

Steering Clear of the Brink … 24
The ***Journal of Private Equity***, an Institutional Investor Publication

Building Value In Companies to Prepare Them For Sale

A Hands On Approach. … 28
Mergers & Acquisitions, The Dealmaker's Journal, SourceMedia, Inc.

Investing in Underperforming Distressed Troubled Companies

Looking For The Exit: An Approach To Investing in Underperforming Companies … 30
Dow Jones Bankruptcy Review, Dow Jones & Company Newsletters

Value Creation Model To Build Value

Value Creation Model. Built to Sell … 33
Shareholder Value Magazine

More →

Table of Contents (Continued)

Defense Conversion — Strategies for Federal Government Contractors

A Director's Guide to Defense Conversion: How to Avoid Minefields in the Marketplace … 35
Director's Monthly, Strategy Briefs

Executive Leadership to Enhance Value

All Leaders Are Not Created Equal: To Save the Company -- Change the Leadership Style … 39
Director's Monthly

Benefits of Outside Directors

Outside Directors Offer Valuable Guidance, Contacts … 42
Baltimore Business Journal

6 Ways Outside Directors Benefit Business Growth. You Need These Guys … 43
President & CEO Magazine

Benefits of Interim Management Executives

Quick Leadership & Benefits of Interim Managers. C-Level Execs Make a Difference … 45
ABF Journal, Asset Based Lenders

Raising Money in Tough Times

Raising Money In Tough Times: Easier Than You May Think. … 48
Turnaround Management Journal

Set Strategy — Building Mission Statement for Direction

Mission Possible: Six Questions Your Mission Statement Should Answer … 50
BMDO Update, National Technology Transfer Center

Incentive-Based Management to Get Results

Incentive-Based Management: If You Want Results, Show Them The Money!- … 52
Fabricator Magazine, Publication of the Fabricators & Manufacturers Association, International.

About the Author: John M. Collard … 54

Writing Credits … 54

About the Firm: Strategic Management Partners, Inc. … 55

Reference Links … 56

Managing Turnarounds Requires Clear Thinking, Quick Action, and a Plan

• • The process for turning around troubled companies is easy to understand and challenging to implement.

© Copyright 2010 by The RMA Journal *March 2010, and* Strategic Management Partners, Inc.
www.StrategicMgtPartners.com (410) 263-9100

© Copyright 2010, Strategic Management Partners, Inc.

By John M. Collard

THERE IS PLENTY of trouble in today's economy, and few industries have been spared hardship. Turnaround opportunities abound for those who have the knowledge and fortitude to go through the process. The rewards can be plentiful and the failures catastrophic.

The process of turning around a troubled entity is complex and made more difficult by the multiple constituencies involved, all having different agendas. Lenders want their invested capital returned, preferably with interest. Creditors want to get paid for goods and services. Original investors want and hope for recovery of their capital, while distressed investors want to buy in at 20 cents on the dollar and then turn a profit, some by trading the credit and others by turning the business positive and then selling. Owners want to avoid guarantees and recoup some of their equity. Employees want to retain their jobs and benefits. Directors want to avoid risk and litigation. Other stakeholders want their interests protected. These varied desires often can be at odds with one another and hamper the turnaround effort.

Let's address the turnaround process as if all constituents favor proceeding through to the end, when a restructured entity emerges, although clearly other scenarios can be envisioned.

The High Cost of Mismanagement

Many causes contribute to business failure. According to a study conducted by the Association of Insolvency and Restructuring Advisors, only 9% of failures are due to influences beyond management's control and to sheer bad luck. The remaining 91% of failures are related to influences that management could control, and 52% are rooted in internally generated problems that management didn't control.

Businesses fail because of mismanagement. Sometimes it is denial, sometimes negligence, but it always results in loss. Mismanagement is most often seen in more than one of multiple areas:

- Autocratic management and overextension.
- Ineffective, non-existent communications.
- High turnover and neglect of human resources.
- Inefficient compensation and incentive programs.
- Company goals not achieved or understood.
- Deteriorating business and lack of new customers.
- Inadequate analysis of markets and strategies.
- Lack of timely, accurate financial information.
- History of failed expansion plans.
- Uncontrolled or mismanaged growth.

Will Rogers said, "If you find yourself in a hole, stop digging." It's good advice for directors and managers with responsibility for leading a company and very good advice for lenders and investors contemplating investing more capital into a troubled entity. This is an opportunity for distressed investors having the "dry powder" to invest at bargain rates, the stable of leaders to affect a turnaround, and the knowledge and chutzpah to take on these challenges.

The Role of Turnaround Specialists

To engineer a successful turnaround, a company needs someone with clear thinking to quickly assess opportunities, to determine what is wrong, to develop strategies that no one has tried before, and to implement plans to restructure the company. The problems are rarely what management indicates they are, but rather are usually two or three underlying, systemic ills that often can be fixed. You can't focus on the symptoms; you must find the real causes. Management has allowed these problems to exist and bring the company to its depressed state. Therefore, management is not equipped to manage the turnaround.

When these circumstances are present, turnaround specialists are often an excellent choice. They bring a new set of eyes trained in managing and advising in troubled situations. These experts are either practitioners or consultants. Turnaround practitioners take management and decision-making control as chief executive officer or chief restructuring officer. As an alternative, turnaround consultants can advise management, perhaps the same management that failed before.

Businesses fail because of mismanagement. Sometimes it is denial, sometimes negligence, but it always results in loss.

The key to turnarounds is building enterprises in which future buyers want to invest. Investors and buyers look for businesses that:

- Create value and exhibit consistency from period to period.
- Have a high probability of future cash flows or have a history of performance and improvement or the promise of cash.
- Possess a market-oriented management team with a focus on producing revenue.
- Are able to sell and compete; to develop, produce, and distribute products; and to thrive and grow as indicated by a track record or demonstrated changes in the right direction.
- Exhibit a fair entry valuation and realistic return potential.
- Have exit options (a high return on investment, or ROI, realized at time of resale).

There is a process of recovery and investment in a turnaround. It is based on the fundamental premise that management is lacking when companies are in trouble. Turnaround specialists must conduct fact-finding to assess the situation and then prepare a plan to fix the problems. They must implement the planned courses of action by funding the process and building a team to carry it out, then monitor progress and make changes where necessary.

Stages in the Turnaround Process

The turnaround process has five stages:

- Management change.
- Situation analysis.
- Emergency action.
- Business restructuring.
- Return to normal.

Let's look at each stage individually to understand the objectives and what should be done by each function within the company. The timing is important to coordinate what's happening between functions. Stages can overlap, and some tasks may impact more than one stage.

The process is designed to first stabilize a situation, which is done by addressing management issues, assessing situation, and implementing emergency actions. The restructuring process begins with preparations during the emergency action phase. Positioning for growth starts with restructuring and grows when the normal stage is reached.

Management Change

It is very important to select a CEO who can successfully lead the turnaround. This individual must have a proven track record and the ability to assemble a management team that can implement the strategies to turn the company around. The best candidate most often comes from outside the company and brings a special set of skills to deal with crisis and change. His or her job will be to stabilize the situation, implement plans to transform the company, and then hire a replacement.

It is essential to eliminate obstructionists who may hamper the process. This move could require replacing some or all of top management, depending on the deal. It will undoubtedly also mean replacing some of the board members who did not keep a watchful eye.

© Copyright 2010, Strategic Management Partners, Inc.

Management must address issues related to the major stakeholder groups: executives, function managers, employees, lenders, vendors, customers, and others. To accomplish a turnaround, a company must make a concerted effort to change how it operates. Most turnaround companies have a lack-of-sales problem that necessitates a change to jump-start sales and drive revenue. There must be information that all can rely on for decision making. Production management must support and make what the market wants to purchase at competitive prices. Management must nurture the critical human capital resources that are left within the company, while at the same time holding them accountable for results.

Changing management is synonymous with changing the philosophy of how a company is run to achieve results. Communication with all stakeholders is paramount throughout all stages of the process. Set goals that achieve stakeholder objectives, then apply incentive-based management to motivate the proper results. Tie everyone to the same broad set of goals and emphasize how functions can complement the performance of related departments.

Situation Analysis

The objective at this stage is to determine the severity of the situation and whether it can be turned around. Questions to ask include:

- Is the business viable?
- Can it survive?
- Should it be saved?
- Are there sufficient cash resources to fuel the turnaround?

This analysis should culminate in a preliminary action plan stating what is wrong, how to fix it, and which key strategies can turn the entity in a positive direction. There should also be a cash flow forecast (at least 13 weeks) to understand cash usage.

Identify effective turnaround strategies. Operational strategies include increasing revenue, reducing costs, selling and redeploying assets, and establishing competitive repositioning. Strategic initiatives include adopting sound corporate and business strategies and tactics and setting specific goals and objectives that align with ultimate stakeholder goals. Too often, goals are misaligned with the ultimate direction and lead to confusion, wasted time, false starts, and employees sent in the wrong direction. Understand that many of the good employees have already left the company. Managements have to work with the "second string" in the interest of time and build as they go.

Understand the life cycle of the business and how it relates to the chosen turnaround strategy. Document key issues so that all parties will understand what you are trying to accomplish and will pull in the same direction. Identify which product and business segments are most profitable, particularly at the gross margin level, and eliminate weak performers and nonperformers. Make certain that all functional areas are working to support the goals of their counterparts. Selling work with flexible delivery times can fill valleys in production cycles, which reduces costs per unit. Producing only what sales staff can sell to meet customer demand will increase sales and gross margin.

Turnaround strategies often are affected by local government policy considerations and regulations. In the United States, the Worker Adjustment and Retraining Notification (WARN) Act requires 60-day notice of massive layoffs, which certainly impacts cash flow. In many countries in Europe and the Far East, stringent rules govern payment of wages after layoffs, as well as dealings with local authorities; some regulations even prioritize which workers can be laid off. When government policy favors labor and employment is not "at will," there will be complications.

Emergency Action

At this stage, the objective is to gain control of the situation, particularly the cash, and establish breakeven. Centralize the cash management function to ensure control. If you stop the cash bleed, you enable the entity to survive. Time is your enemy. Protect asset value by demonstrating that the business is viable and in transition.

You must raise cash immediately. Review the balance sheet for internal sources of cash, such as collecting accounts receivable and renegotiating payments against accounts payable. Sell unprofitable business units, real estate, and unutilized assets. Secure asset-based loans if needed. Restructure debt to balance the amount of interest payments with the level the company can afford.

Lay off employees quickly and fairly. It is much better to cut deep all at once than to make small cuts repeatedly. Remaining employees are more likely to focus if they believe their jobs are secure.

Rightsizing the company means much more than laying off employees. Correct underpricing of products, prune product lines to only those that are profitable and meet demand, and weed out weak and problem customers. Sometimes too much overhead is applied to support customers that aren't paying their fair share of that service. Emphasize selling more product at profitable rates. Reward those who change the situation; sanction or release those who don't.

Business Restructuring

In this stage, the objective is to create profitability through remaining operations. Stress product-line pricing and profitability. Restructure the business for increased profitability and return on assets and investments. This is the point at which the focus should change from cash flow crisis to profitability. Fix the capital structure and renegotiate the long- and short-term debt.

Ensure reporting systems put in place are operationalized to show profitability at each revenue center, cost center, profit center, cash center, incentive center. If employees can't see it, they can't manage it.

Incentive-based management drives employees to get involved smartly and manage to the goals all ascribe to. Create teams of employees to identify and rework inefficiencies and promote profitability.

There are only two ways to increase sales: 1) sell existing product to new customers, and 2) sell new products to existing customers. If you want growth, do both.

Return to Normal

The goal at this final stage is to institutionalize the changes in corporate culture to emphasize profitability, ROI, and return on assets employed. Seek opportunities for profitable growth. Build on competitive strengths. Improve customer service and relationships. Build continuous management and employee training and development programs to raise the caliber of your human capital.

This could be time to restructure long-term financing at more reasonable rates now that the company is stable and on a path to growth.

The odds of a successful turnaround increase dramatically if a turnaround phases-and-actions plan is implemented and followed (table). This plan can certainly be adapted to unique situations when required.❖

***John M. Collard** is chairman of Strategic Management Partners Inc., (www.StrategicMgtPartners.com), Annapolis, Maryland, a turnaround management firm specializing in interim executive leadership, private equity advisory, asset recovery, corporate renewal governance, and investing in underperforming distressed companies. Inducted into the Turnaround Management, Restructuring, Distressed Investing Industry Hall of Fame, he is a certified turnaround professional and past chairman of the Turnaround Management Association. Contact him at John@StrategicMgtPartners.com or 410-263-9100.*

***The RMA Journal** is the official publication of the Risk Management Association. RMA is a professional association whose objective is to further the ability of members to identify, assess, and manage the impacts of credit risk, operational risk, and market risk on their businesses and their customers. Serving the Financial Services Industry.*

Copyright 2010 Risk Management Association (www.rmahq.org). All rights reserved. Used by permission of RMA.

Turnaround Phases and Actions

Stage	Management Change (Leadership)	Situation Analysis (Viability)	Emergency Action (Crisis Control)	Business Restructuring (Change)	Return to Normal (Going Concern)
Objectives	• Put top management team in place. • Select turnaround specialist. • Replace some/all top management. • Eliminate impediments.	• Can the company survive? • Should it be saved? • Is the business viable? • Are cash resources available to fuel turnaround? • Develop preliminary action plan and nature of turnaround.	• Go into survival mode. • Get control. • Establish breakeven. • Turn cash flow positive. • Raise cash to support turnaround. • Protect resources. • Protect asset value.	• Create profitability through operations. • Restructure business for increased return on assets and investment.	• Seek profitable growth. • Emphasize profits and returns. • Build competitive strengths.
Sales and Marketing	• Jump-start sales. • Drive revenue. • Volume in = revenue.	• Analyze products and services distribution, sales and marketing strategies and systems.	• Correct underpricing. • Prune product lines. • Weed out weak customers and distributors. • Bring sales and marketing costs within industry average. • Sell, sell, sell more.	• Reassess competitive and product line pricing. • Exploit existing products. • Develop new products. • Improve customer and distribution mix. • Improve sales and marketing effectiveness.	• Explore new markets and customer segments. • Examine industry restructuring opportunities. • Pursue value-added chain restructuring. • Consider synergistic diversification.
Financial	• Track cash. • Develop trusted reporting and analysis.	• Analyze cash flow, breakeven, profitability, cost reduction, balance sheet, and reporting gross margin by product.	• Restructure debt. • Improve work/capital. • Sell nonproducing assets. • Reduce cost/ increase revenue. • Eliminate creative accounting practices.	• Improve liquidity. • Clean up balance sheet. • Fix capital structure. • Develop control systems. • Create managerial accounting system.	• Develop strategic accounting. • Restructure long-term financing. • Develop stock valuation and buyback system.
Manufacturing and Production Operations	• Produce to meet sales levels only. • Balance peaks and valleys. • Volume out = throughput.	• Analyze facilities, equipment, systems and procedures, and suppliers.	• Shut down operations. • Reduce work force. • Reduce inventories. • Control purchases. • Increase productivity.	• Develop productivity improvement programs. • Reevaluate overhead. • Establish ongoing profit improvement programs.	• Restructure operations for competitive advantage. • Consider strategic alliances with world-class firms.
Engineering, Research and Development	• Develop new products and services to support sales.	• Analyze new product development, improvements in product, process, and productivity.	• Accelerate high-potential projects. • Shut down tangential projects. • Unbundle product offerings.	• Make new product development market- and customer–oriented. • Build an economic value-added orientation into process engineering.	• Establish advanced technology monitoring systems. • Seek competitive advantage, strategic leverage in all R&D activities.
Organization	• Organize for change. • Rightsize the company.	Analyze systems: • Does organizational structure make sense? • Accounting/Control. • Incentive/performance measurement and compensation.	• Structure turnaround team. • Review individual accountability and teamwork. • Reward those who change the situation; release those who don't.	• Restructure for competitive effectiveness. • Develop rewards that reinforce turnaround. • Demonstrate with action the seriousness of the situation.	• Restructure to reflect changing strategies. • Organize to succeed, then fill positions with talented people. Don't compromise.
Personnel and Human Resources	• Hold employees accountable. • Nurture critical human capital resources. • Slow the turnover rate. • Institute incentive-based management.	• Analyze management team; sales, finance, and ops personnel; recruiting, selection, training, starting, and promotional systems.	• Get peoples' attention. • Establish who's in charge. • Create a professional, business-like atmosphere. • Sanction nonperformers.	• Improve people mix. • Institute incentive-based management. • Bolster people to believe in consistent reward system. • Get people to think profit, ROI, and cash flow.	• Institutionalize continuous management and employee training and development programs. • Grow human assets.

© Copyright 2010 by The RMA Journal *March 2010, and* Strategic Management Partners, Inc.
www.StrategicMgtPartners.com (410) 263-9100

NACD
Directorship
The Magazine of the National Association of Corporate Directors

Managing Turnarounds in Times of Crisis

Phases and Actions To Accelerate the Recovery Process

By John M. Collard | January 15, 2010

The process of turning around a troubled entity is complex. This is made more difficult and compounded by the multiple constituencies involved, all of whom have different agendas. Directors want to avoid risk and litigation. Lenders want return of invested capital, preferably with interest. Creditors want their money in exchange for goods and services. Original investors want and hope for recovery of capital. Owners want to avoid guarantees and recoup some equity. Employees want jobs and benefits. Other stakeholders want their interests protected. These desires can often be at odds with other parties and hamper the effort.

Address the turnaround process as if all constituents are in favor of proceeding to the end, when a restructured entity emerges.

There are many causes that contribute to business failure. According to a study conducted by the Association of Insolvency and Restructuring Advisors only 9 percent of failures are due to influences beyond management's control and to sheer bad luck. The remaining 91 percent of failures are related to influences that management could control, and 52 percent are internally generated problems that management didn't control.

Businesses fail because of mismanagement. Sometimes it's denial, sometimes negligence, but it always results in loss. Mismanagement is most often seen in more than one of multiple areas:

- Autocratic Management, Overextension
- Ineffective, Non-existent Communications
- High Turnover Neglect of Human Resources
- Inefficient Compensation & Incentive Programs
- Company Goals Not Achieved or Understood
- Deteriorating Business, No New Customers
- Inadequate Analysis of Markets & Strategies
- Lack of Timely, Accurate Financial Information
- History of Failed Expansion Plans
- Uncontrolled or Mismanaged Growth

Will Rogers said, "If you find yourself in a hole, stop digging." Good advice for directors with responsibility to lead a company.

Turnaround specialists are often an excellent choice when these circumstances are present. They bring a new set of eyes, trained in managing and advising in troubled situations. These experts are either practitioners or consultants. Turnaround practitioners take management and decision-making control as the chief executive officer or chief restructuring officer. Turnaround consultants on the other hand advise management, perhaps the same management that failed before.

The Turnaround Management Association (TMA) was formed in 1988 and has grown to 8,600 members around the world who represent multiple constituencies working in the industry. TMA sponsors a Certified Turnaround Professional (CTP) program with strict reference checking requirements and testing of a Body of Knowledge to become certified. Approximately 500 CTP professionals are registered today.

The key is to build enterprises that future buyers want to invest in. Investors/buyers look for:

- Businesses that create value. Consistency period to period.
- High probability of future cash flows. History of performance and improvement, or the promise of cash.
- Market-oriented management team. Focus on producing revenue.
- Ability to sell and compete; develop, produce, and distribute products; thrive and grow. Track record or demonstrated changes in the right direction.
- Fair entry valuation. Realistic return potential.
- Exit options. Realize high ROI at the time of their resale.

There is a process of recovery and investment. It is based upon the fundamental premise that there is a lack of management when companies are in trouble. You must conduct fact-finding to assess the situation, then prepare a plan to fix the problems. You must implement the planned courses of action by funding the process and building a team to carry it out. Then monitor the progress and make changes where necessary.

Stages in the Turnaround Process

There are five stages in the turnaround process: Management Change, Situation Analysis, Emergency Action, Business Restructuring, and Return to Normality. We will look at these individually to understand what should transpire at each stage by each function within the company. The timing is important to coordinate what is happening between functions. Stages can overlap, and some tasks may impact more than one stage.

The process is designed to first stabilize the situation, which is done by addressing management issues, assessing the situation, and implementing emergency actions. The restructuring process begins with preparations during the emergency action phase. The positioning for growth starts with restructuring and grows when normalcy stage is reached.

Management Change Stage

It is very important to select a CEO who can successfully lead the turnaround. This individual must have a proven track record and the ability to assemble a management team that can implement the strategies to turn the company around. This individual most often comes from outside the company and brings a special set of skills to deal with crisis and change. Their job will be to stabilize the situation, implement plans to transform the company, then hire their replacement.

It is essential to eliminate obstructionists who may hamper the process. This could require replacing some or all of top management depending on the deal. This will undoubtedly mean also

© Copyright 2010, Strategic Management Partners, Inc.

replacing some of the board members who did not keep a watchful eye.

Management must address issues related to major stakeholder groups (executives, function managers, employees, lenders, vendors, customers, others). There must be change in the focus of how the company will operate to accomplish a turnaround. Most companies have a lack-of-sales problem, which necessitates a change to jump-start sales and drive revenue. There must be information that all can rely on for decision making. Production management must support and make what the market wants to purchase, at competitive price. You must nurture critical human capital resources that are left within the company, while at the same time holding them accountable for results.

Changing management is synonymous with changing the philosophy of how we will run the place to achieve results. Communication with all stakeholders is paramount through all stages of the process. Set goals that achieve stakeholder objectives, then apply incentive-based management to motivate the proper results. Tie everyone to the same broad set of goals and accent how functions can compliment the performance of related departments.

Situation Analysis Stage

Your objective is to determine the severity of the situation and if it can be turned around. Answer questions like is the business viable? Can it survive? Should it be saved? Are there sufficient cash resources to fuel the turnaround? This analysis should culminate in formulating a preliminary action plan stating what is wrong, how to fix them, key strategies to turn the entity in a positive direction, and a cash flow forecast (at least 13 weeks) to understand cash usage.

Identify effective turnaround strategies. Operational strategies include increasing revenue, reducing costs, selling and redeploying assets, and competitive repositioning. Strategic initiatives include adopting sound corporate and business strategies and tactics, setting specific goals and objectives that align with the ultimate goals of the stakeholders. Too often, goals are misaligned with the ultimate direction and cause confusion, wasted time, false-starts, and send employees in the wrong direction. Understand that many of the good employees have already left the company, you will have to work with the second string in the essence of time and build as you go.

You must understand the life cycle of the business and how it relates to the chosen turnaround strategy. Document key issues so that all will understand what you are trying to accomplish, and all will pull in the same direction. Identify what product and business segments are most profitable, particularly at the gross margin level, and eliminate weak and nonperformers. Make certain that all functional areas (sales, production) are working to support the goals of their counterparts. Selling work with flexible delivery times can fill valleys in production cycles, which reduce costs per unit. Producing only what sales can sell to meet customer demand will increase sales and gross margin.

Turnaround strategies are often impacted by local government policy considerations and regulations. In the United States the WARN Act requires 60-day notice of massive lay-offs, which certainly impacts cash flow. In many countries in Europe and Far East there are stringent rules (local country driven) governing the payment of wages after lay-offs, dealing with the local authorities regarding the process, and even prioritizing which workers can be laid off when in fact others may be more qualified. When government policy favors labor and employment is not "at will" there will be complications to the process.

Emergency Action Stage

Your objective is to gain control of the situation, particularly the cash, and establish breakeven. Centralize cash management function to ensure control. If you stop cash bleed, you enable the entity to survive. Time is your enemy. Protect asset value by demonstrating that the business is viable and in transition.

You must raise cash immediately. Review the balance sheet for internal sources of cash such as collecting accounts receivable, and renegotiating payments against accounts payable. Sell unprofitable business units, real estate, unutilized assets. Secure asset-based loans if needed. Restructure debt to balance the amount of interest payments with a level a company can afford.

Lay off employees quickly and fairly. It is much better to cut deep all at once, than to make small cuts repeatedly. Remaining employees are more prone to focus if they believe in job security, rather than look for the next action.

Rightsizing the company is much more than employee layoffs. Correct underpricing of products, prune product lines to only those profitable and that meet demand, and weed out weak and problem customers. Sometimes there is to much overhead applied to support a customer who isn't paying their fair share of that service. Emphasize selling more product at profitable rates. Reward those that change the situation, sanction or release those that don't.

Business Restructuring Stage

Your objective is to create profitability through remaining operations. Stress product line pricing and profitability. Restructure the business for increased profitability and return on assets and investments. At this stage your focus should change from cash flow crisis to profitability. Fix the capital structure and renegotiate the long and short term debt.

Ensure that reporting systems put in place are operationalized to show profitability at each revenue center, cost center, profit center, cash center, incentive center. Unless employees can see it they can't manage it.

Incentive-based management will drive employees to get involved smartly, and manage to the goals all ascribe to. Create teams of employees to identify and rework inefficiencies and promote profitability.

There are only two ways to increase sales. Sell existing product to new customers. Sell new products to existing customers. Do both if you want growth.

Return to Normal Stage

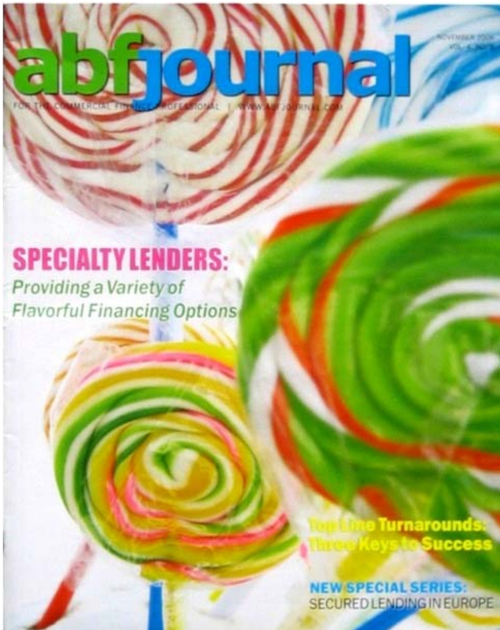
Your objective is to institutionalize the changes in corporate culture to emphasize profitability, ROI, and return on assets employed. Seek opportunities for profitable growth. Build on competitive strengths. Improve customer service and relationships. Build continuous management and employee training and development programs to raise the caliper of your human capital.

This could be time to restructure long term financing that more reasonable rates now that company is stable on a growth path.

The odds of a successful turnaround are increased dramatically if a Turnaround Process Phases and Actions Plan is implemented and followed. This plan can certainly be adapted to unique situations when required. Turn one around.

John M. Collard is chairman of Annapolis, Maryland-based Strategic Management Partners Inc., a turnaround management firm specializing in interim executive CEO leadership, asset recovery, corporate renewal governance, private equity advisory, and investing in underperforming distressed troubled companies. 410-263-9100
www.StrategicMgtPartners.com

© Copyright 2010, Strategic Management Partners, Inc.



Recover & Preserve Value: Working Successfully With Turnaround Professionals

By John M. Collard

Turnaround Corner

Part 1 of 2

The turnaround of a business in financial distress involves managing the business and its problems. The process is time consuming and requires a special set of skills. The problems of the business are often compounded by owners or management who are facing financial distress for the first time and who are reticent to change. This is where a turnaround specialist brings his art to the process.

The identity of the client must be clear. The client's identity may appear clear at first glance, but it can quickly become blurred. For example, the owner of a closely held business may be as concerned about personal guarantees as about the survival of the business. In addition, if the lender has referred the specialist, the specialist must make it clear to all parties whether the lender or the business is the client.

Turnaround specialists generally are either interim managers or consultants. Interim managers will replace the CEO, take the decision-making reins of a troubled business, and guide it through its troubled waters, hopefully to safety. Turnaround consultants advise existing management without taking an operating role within the company. Although some specialists are willing to act as either an interim manager or a consultant, most prefer to act as one or the other.

A troubled business may also need the help of an experienced general manager or an expert in a particular aspect of the business. A troubled business often has a unique problem that requires an industry-knowledgeable expert rather than a experienced general manager. Naturally, this determination depends upon the particular company, industry, and problems involved. Keep in mind, however, that industry knowledge is not the same as turnaround management knowledge. A skilled turnaround specialist can often revive a company using his/her turnaround talents despite initial unfamiliarity with the technical aspects of the business.

Many turnaround specialists also concentrate on varying stages of business decline. While some practitioners work with clients in or on the edge of bankruptcy, others concentrate on only those in an early stage of decline.

Is A Turnaround Specialist Needed?

Before this question can be answered, it is important to understand why businesses fail. The answer is usually mismanagement. Some of the many internal and external factors controlled by management include:

- ***Autocratic management*** resulting in overextended management, unclear lines of authority.
- ***Ineffective communications***, unnecessary meetings, etc.
- ***Neglect of human resources*** evidenced by excessive turnover rates.
- ***Inefficient compensation and incentive programs.***
- ***Company goals that are not understood or achieved.***
- ***Deteriorating business*** from established clients, indicating strategies are outdated.
- ***Inadequate analysis of markets and strategies.***
- ***Lack of timely and accurate financial information.***
- ***History of failed expansion plans.***
- ***Uncontrolled or mismanaged growth.***

Management is often prone to blame the misfortunes of the business on external factors ostensibly beyond their control rather than to be held accountable and correct the situation. Some of these external factors include:

- **General economy**
- **Unfavorable legislation**
- **Interest rate fluctuations**
- **Labor unrest**
- **Labor cost increases**
- **Competition**
- **Litigation**
- **Market decline**
- **Raw material cost increases**

© Copyright 2010, Strategic Management Partners, Inc.

WARNING SIGNS: How Do You Diagnose Trouble?

What are the warning signs of a business heading toward trouble? This is one of the most frequently asked questions of turnaround specialists. Trouble comes from a variety of causes. The obvious signals are rarely the root cause of the problem. Losing money, for example, is not the problem, but the result of other problems.

The warning signs listed below are not all-inclusive, but may provide some insight as to why the company is facing difficulty. Signs connected with operational performance include:

- **Decrease in profit**
- **Lack of short- and long-term planning and forecasting**
- **Quality control problems - returned goods, complaints**
- **Late or slow delivery**
- **Increase in fixed costs relative to revenues**
- **Management and employee turnover**
- **General employee dissatisfaction and performance**
- **Employee layoffs**
- **Declining revenues per employee**
- **Trade credit difficulties and restrictions**
- **Failure to take purchase and other cash discounts**
- **Delay returning telephone calls**
- **Delay submitting financial to banks, lenders, suppliers**
- **Board of Directors resignations**
- **Auditor resignations or turnover**
- **Failure of board of directors to diligently exercise its oversight function**
- **Return "retired" founder to visible management position**
- **Failure to adapt to new technologies**

Signs relating to a company's financial performance include:

- **Decrease in profit**
- **Decrease in sales**
- **Continued failure to meet bank loan covenants**
- **Decrease in available cash**

Signs associated with poor asset utilization include:

- **Worsening cash position - reduced working capital**
- **Decrease in quick asset ratio**
- **Increase in the debt to equity ratio**
- **Dwindling capital base**
- **Declining asset turnover rate**
- **Declining accounts receivable turnover rate**
- **Deteriorating account receivable aging**
- **Declining inventory turnover rate**
- **Deteriorating account payable aging**
- **Creeping loan balances**
- **Reduced R&D expenditures**
- **Changing accounting principles**
- **Financing purchase of fixed assets with working capital**
- **Overpaying for assets or business units**
- **Acquisitions of or expansion into non-core businesses or which cut into or compete with the core business**

These signs are symptoms, not the problem. The signs are simply the evidence that a problem exists, and it is the problem rather than the symptom that must be identified and remedied.

Several Formulas Exist to Predict Failure.

One widely known formula is the Z-Score, developed by Professor Edward Altman of New York University. By weighing various financial ratios, the Z-Score attempts to predict whether a manufacturing company is a bankruptcy candidate.

The formula: $Z = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E$

Where:

A = Working Capital / Total Assets

B = Retained Earnings / Total Assets

C = Earning Before Interest and Taxes / Total Assets

D = Market Value of Equity* / Book Value of Total Debt

E = Sales / Total Assets

(*)When the company is not publicly traded, book value of equity should be substituted for market value.

Resulting scores are interpreted to indicate the following:

√ **Less than** 1.8 — The company has a high probability for bankruptcy within the next two years.

√ **Between** 1.8 & 3.0 — The gray zone where the trend is really the most important criteria.

√ **Greater than** 3.0 — The company has a low probability for bankruptcy.

A second statistical method developed by Jarrod Wilcox, former assistant professor at MIT's Sloan School of Business, is known as the Gambler's Ruin Prediction of Bankruptcy. This formula, designed to predict possible bankruptcy for manufacturing and retail companies up to five years in advance, is as follows:

Liquidation Value = Assets - Liabilities

Where:

Assets = 100% of cash and marketable securities plus 70% of accounts receivable, inventory, and prepaid expenses plus 50% of remaining assets.

Change in Liquidation Value from previous year = Earnings before special items minus 100% of dividends minus 50% of year's capital expenditures and depreciation minus 30% of increase in inventory and accounts receivable since prior year.

If these computations indicate negative amounts, the company is considered a candidate for bankruptcy.

Companies Susceptible to Trouble

Given the market forces of capitalism, all businesses are as vulnerable to trouble as they are to the lure of success. We live in a world of wildly changing technologies. Even with these changes, a business that is managed properly will continue to prosper. However, some industries are more susceptible to trouble than others due to various factors and characteristics.

The fortunes of companies in ***cyclical industries*** often depend upon forces outside their control such as commodity prices or weather conditions. Those most likely to withstand the effects of these forces are the ones that learn to adapt. They either sufficiently diversify without losing sight of their primary business or are able to control fixed costs in unstable conditions. The ability to adapt is key.

© Copyright 2010, Strategic Management Partners, Inc.

Companies in ***newly deregulated industries*** face having to learn to survive in a competitive environment without the legal protections previously enjoyed. Deregulation is generally accompanied by an anticipated shakeout of the weakest businesses as competitive forces take hold in the marketplace.

As the United States has evolved from a primarily manufacturing driven economy to an economy increasingly driven by ***service-oriented industries,*** management must recognize that its most irreplaceable assets are employees. Managing human resources is more important than ever.

Companies lacking a proprietary product, - or "me-too" companies - are subject to attack from every direction. Examples of these companies are retail businesses and non-licensed service sector businesses. They face low entry barriers both with respect to capital and expertise and a multitude of competitors.

Many entrepreneurial companies and start-ups are ***single-product and single-customer companies.*** In order to succeed, these companies usually must develop new products or diversify to compete and satisfy customers. Few are able to maintain their start-up success, but instead struggle to compete with existing competition and new market entrants. Reaching maturity takes years during which the company is vulnerable.

Rapidly growing companies are often driven by entrepreneurial zeal and overwhelming emphasis on sales. Often, inadequate attention is given to the effects of growth on the balance sheet. With huge sales increases and significant investments into R&D, these companies suddenly find themselves in a situation where the balance sheet simply cannot support the growth.

Highly leveraged companies have so many factors that must converge to be successful that they are often most susceptible to the external uncontrollable causes of business failure, such as interest rate fluctuations or an increase of raw material costs.

Closely held businesses and family owned businesses, by their nature, select leadership based not upon managerial talent but by virtue of family or close personal relationships with the shareholders. More than in other businesses, owner/managers link their personal psyche to that of their business. To the owner/managers, business failure is often perceived as a personal failure. Owner/managers often believe that they are irreplaceable or are afraid to admit that they are not. They want to maintain control, and consequently, they fail to either develop a management team or a plan for transition of management. These owner/managers are reluctant to acknowledge early warning signs of failure and are also apt to ignore them.

Perhaps ***declining industries*** face the most difficult task of all. Declining industries are those in which total industry-wide unit shipments are declining. Maintaining market share involves shrinking. Maintaining volume involves increasing market share (i.e., taking business from competitors). Management, which refuses to admit that the industry is declining or bets its future on the industry recovering, is the most prone to failure.

Approximately 70% of ***entrepreneurs and start-ups*** fail within two years. Entrepreneurs do not necessarily come from managerial backgrounds. They have visions of what the future will look like before the rest of us know to invent the better mouse trap. Their *modus operandi* is to capitalize on their head start as a way to convert their vision to a profitable reality. The same skills that keep an entrepreneur focused on an idea, regardless of obstacles, can make him oblivious to the competition on his heels or to new changes in the market. Ultimately, the market does catch up, forcing the entrepreneur to compete in a mature industry rather than in an emerging industry. As entrepreneurs survive the transition to professional management and new technologies gain a stronghold on the economy, emerging industries are born.

Hiring A Turnaround Specialist

Before seeking a turnaround specialist, a business should attempt to understand its desires and needs and it should be willing to face the reality of very difficult issues. With statistics generally pointing to mismanagement at the root of most crises, the business should be aware that the turnaround specialist will perform a quick study of management capability. Management must be committed to participate in the recovery, agree that the turnaround specialist is the catalyst to the recovery, and undertake to learn as much as possible so that it can better manage the business at the conclusion of the turnaround engagement.

Thus, before calling a turnaround specialist, management should ask itself some hard questions:

- **Can a turnaround be realistically achieved?**
- **Is management aware that a true turnaround can take years to accomplish?**
- **Have business issues been isolated from personal issues? Or, is the primary goal of hiring the specialist to protect the owner from personal guarantees and preserve personally owned assets?**
- **What can be reasonable and realistically expected from the turnaround specialist?**
- **Is management willing to admit the business' problems are, in all likelihood, the result of mismanagement?**
- **Is management willing to become, if necessary, the student rather than the teacher or the follower rather than the leader?**
- **If asked to give up the controls of the business, is management willing to do so?**
- **Is management willing to face its own shortcomings and to face facts that may reflect on its ability?**
- **Since the turnaround specialist is often a temporary fix, is management willing to change?**
- **Can management learn to function in a highly controlled environment, subject to being monitored by outsiders?**
- **Is management willing to accept business' failure since some are simply unavoidable and not savable?**
- **Is management willing to agree to a turnaround specialist's engagement if the only realistic expectation is to maximize liquidation value even if the ultimate result is the failure of the business?**
- **Is management willing to sell control and become both a minority shareholder and an employee of a new board of directors if necessary to attract the capital to preserve the company?**
- **Is management, in the case of smaller businesses particularly, willing to face stigma of bankruptcy?**

© Copyright 2010, Strategic Management Partners, Inc.

How To Select a Turnaround Specialist

Owners should be cautious and deliberate in selecting a turnaround specialist. Retaining a turnaround specialist has been analogized to having a heart transplant, an experience few would undertake without much trepidation. But just as heart transplants are necessary to save the life of the patient, a corporate turnaround is very often what is needed to keep a business alive.

Interviews and Background Checks

Owners should do their homework before interviewing any turnaround specialist. Resumes and references should be requested and checked in advance. Owners should not be misled by professional affiliations and should avoid hiring unneeded skills. Beware of an unemployed CEO or CFO masquerading as a turnaround specialist. Simply having a background as a CEO does not mean that the candidate will possess the needed skills to be a good turnaround specialist. Lawyers, accountants, bankers, and financial advisors should be consulted for their opinions and advice.

Several specialists should be interviewed. Despite their hopes, owners should neither expect miracles nor be misled by unrealistic promises or guarantees of success. What the turnaround specialist offers should be weighed against what is realistically achievable.

Be introspective, as the questions above suggest. But when the turnaround specialist arrives, answer his questions, help him find his answers, and above all, listen. Do not forget that owners and management must work together as a partner with the turnaround specialist. Existing management is a key resource for the turnaround specialist and should adopt an attitude that it wants to learn as much as possible so that it will have the skills necessary to run the business when the turnaround specialist's engagement has been completed.

Time Commitment of the Turnaround Team

Ask the turnaround specialist about his/her work schedule. Meet the entire turnaround team, particularly those who will be on the company premises. Obtain commitments regarding the turnaround specialist's personal involvement. Understand what functions he will perform and what will be delegated to his staff. Ask about the interplay between the company's management, the company's staff, and the turnaround team.

Select an Individual

The personal chemistry between the turnaround team and management is critical to the success of the recovery. Thus, select a person, not a firm or a reputation. A turnaround is a very personal and highly sensitive operation. Management should select the specialist it thinks can do the best job, not a firm because it has a good reputation. The reputation will not turn around the company; an individual might.

Credibility

Learn about the turnaround specialist's relationship with your lender, other potential lenders, trade creditors, and alternate suppliers. Make sure the specialist brings credibility. Companies in trouble often need access to products and funds. One of the resources the turnaround specialist brings to the engagement is credibility to lenders, and consequently, enhanced access to credit. A troubled business often needs more money than its existing lender will supply, and therefore, management assumes a successful turnaround will involve a new lender. This logic, however, often ignores the relationship between the company's operating problems and its lender. It is unreasonable to anticipate that a new lender will be more lenient. In fact, a new lender will likely extract stricter covenants and restrictions, charge significantly higher fees because of the risk of going into a troubled situation, and monitor the loan much more closely. Therefore, the "old" bank may be the company's best source of new money if credibility can be re-established.

Obtain a Written Proposal

Always obtain a written proposal from the turnaround specialist. That proposal should address the turnaround specialist's initial findings, expectations from you and your staff, professional fees, anticipated use of the company's staff, a time line overview, who will be assigned to the engagement, how much time the turnaround specialist expects to commit to the engagement, whether the turnaround specialist will be on hand to implement the plan, at what point the turnaround specialist would expect to withdraw from the engagement, the complete fee structure, and how the turnaround specialist will assist in whatever management changes are necessary. Finally, insist upon and enter a written engagement agreement prior to engagement.

Regular Written Reports

Ask for regular written reports from the specialist. These reports should be concise and timely. They will force the turnaround specialist to organize his thoughts, get to the essence of what has happened in the reporting period, not require a significant amount of his time, and make it clear that he works for the company.

Involvement in Company's Operations

Expect the turnaround specialist to involve the company's staff in the daily operations of the business. Seek from the company's staff an evaluation of the performance of the turnaround specialist. Although the initial engagement of a turnaround specialist can be unsettling, management and staff should be made to understand that their jobs are linked to the turnaround effort. Share those evaluations with the turnaround specialist.

Confidentiality and Accessibility

Most importantly, demand and expect both confidentiality from and accessibility to the turnaround specialist. Though the turnaround specialist may be brutally honest with the client, he must present the client in the best light possible to others. Given precarious circumstances, the company must have as much access as it needs to its turnaround specialist. **abfj**

John M. Collard, is Chairman of Annapolis, MD-based Strategic Management Partners, Inc., a nationally recognized turnaround management firm specializing in interim executive leadership and investing in underperforming companies. He is Past Chairman of the Turnaround Management Association, a Certified Turnaround Professional, and brings 35 years senior operating leadership, $85 million asset recovery, 40-plus transactions worth $780 million, and $80 million fund management expertise to advise company boards, litigators, institutional and private equity investors. Collard can be reached at 410-263-9100. Or, for more information, visit www.StrategicMgtPartners.com

© Copyright 2010, Strategic Management Partners, Inc.

Recover & Preserve Value:

Working Successfully With Turnaround Professionals

By John M. Collard

Part 2 of 2

How Turnaround Specialist Operates

The turnaround specialist offers a new set of eyes, skills and understanding of troubled situations to independently evaluate a company's circumstances. The turnaround specialist very quickly must face a series of questions that existing management may never have asked, such as: What is the purpose of this business? Should it be saved? If so, why? Are those reasons valid?

The turnaround specialist must gather information, evaluate it for accuracy and analyze it quickly so that those initial questions can be addressed openly and honestly. That process generally focuses upon the following issues:

- **Is the business viable?**
- **Is there a core business?**
- **Are there sufficient sources of cash to fuel a recovery?**
- **Is existing management capable of leading company?**

The specialist should discuss those questions openly with his client, and if it is determined the answer to any of the above questions is "No," the parameters of the engagement should be reexamined. Should a specialist still be engaged? What kind of plan is needed to otherwise minimize the losses and to maximize the value of the business for the benefit of his client.

The process of recovery undertaken by the turnaround specialist involves several stages.

Fact-finding. The turnaround specialist must learn as much as possible as quickly as possible so that he can assess the present circumstances of the company.

Analysis of the facts. The turnaround specialist should prepare an assessment of the current state of the company.

Preparation of a business plan outlining possible courses of action. Depending upon the engagement and who his client is, the specialist will seek client input to determine which of alternative courses of action should be undertaken.

Implementation of the business plan. Once the course of action has been chosen, the specialist should be involved to put the plan in place whether as interim manager or as a consultant to management. This is the time a specialist begins to build a team both inside the company and from outside resources.

Monitor the business plan. The specialist should keep vigil over the plan, analyzing variances to determine their causes and the validity of the underlying assumptions.

Stabilization and transition. Assuming liquidation is not a cornerstone of the business plan, a specialist should remain involved in an engagement until stabilization is achieved and to assist a business in transition of management if necessary.

Turnaround specialists immediately focus on cash flow since it is often a cash shortage that causes troubled businesses to seek help. The specialist's first goal is to stabilize cash flow and stop the hemorrhage. The specialist performs a quick analysis of the company's sales and profit centers and of its asset utilization.

In many cases, these factors indicate that the business may have lost focus of its core. To remedy cash shortage, turnaround specialists generally analyze which assets are available to generate a quick infusion of cash and which operations could be terminated thereby stopping the cash outflow. These are difficult decisions since they intrinsically involve down-sizing the company and eliminating some jobs. On the other hand, it has the effect of saving the good parts of the company - and many jobs.

After the specialist has been engaged and a business plan designed, the specialist plays many roles. Since many troubled businesses often lose much of their credibility with lenders, trade suppliers, employees, customers, shareholders, and the local community at large, retaining a turnaround specialist is often the first sign to outsiders that the company is taking positive steps toward both recovery and rebuilding damaged relationships. The turnaround specialist usually serves as a liaison or intermediary with these outside constituencies to calm troubled waters and to present bad news as a preamble to a plan for recovery.

Because management's credibility is often strained, the specialist actively assists in the preparation of a viable business plan and advocates its approval and adoption by the various constituency groups whose cooperation is necessary for implementation. The turnaround specialist is experienced in negotiating both with lenders and with trade suppliers in the midst of a crisis. The turnaround manager brings their personal integrity, their own credibility, and their track record to the table in contrast to that offered by existing management, which finds itself in a downturn.

© Copyright 2010, Strategic Management Partners, Inc.

The turnaround specialist often directs communication for the troubled company with outsiders and company employees. The job of the turnaround specialist is to determine what is in the best interests of the business objectively, regardless of any other agendas. The turnaround specialist must take into account the objectives of the assignment and approach difficult decisions without the weight of historical expectations on his back.

The effective turnaround specialist is a teacher and knows that it is critical to success that a capable management team with acute awareness of its goals must be left behind. If management is deficient, the turnaround specialist has the very delicate task of communicating that message, identifying appropriate roles for existing managers and facilitating a transition.

Special skills the turnaround specialist may also bring to the engagement include knowledge of sources of *de nova* financing and familiarity of trade relationships necessary to assure the flow of product the company needs to fuel its recovery.

Business Ownership's Resistance to Turnaround Specialists

Given difficult questions that a troubled business must face, there is often tension between owners, management, employees of the company and the turnaround specialist. One main problem is that businesses in trouble will often postpone action because their own owners no longer can tolerate jarring change and an uncomfortable transition to something new. Despite statistics indicating otherwise, owners and management may generally believe that its particular situation fits within those minority cases in which decline is attributable to uncontrollable external factors.

A variety of misconceptions and myths abound, which make businesses leery about hiring a turnaround specialist.

The turnaround specialist has "no heart". He does not care about employees, long-time suppliers or bank with whom the company has been doing business for many years. He is cutting employees and telling creditors that they are not going to be paid. Do not forget that the specialist is goal oriented and recognizes that his job is to make hard decisions. The turnaround specialist is an experienced negotiator with creditors to whom he tells the truth, be it good or bad and relies upon his credibility to build the consensus necessary to build for the future.

The turnaround specialist does not understand the company's corporate culture. This is a legitimate observation, but it does not follow that without history on his side, the turnaround specialist is not capable of bringing order out of chaos and adding value to the client. One of the most appealing aspects of a turnaround specialist is that he brings a new set of eyes to a situation as well as an experienced and knowledge base of managing businesses through the turnaround process.

The company's employees have no loyalty to the turnaround specialist. Just remember that management, labor and the turnaround specialist have a responsibility to the organization to work together for the common good, and any power struggles will ultimately hurt the company and the turnaround effort.

The turnaround specialist does not know the client's particular business or industry. The skill the specialist brings to the table is his management ability, his ability to marshal resources and maximize the value from those diverse resources. If the business requires special expertise, the turnaround specialist should assist in attracting that expertise. Most importantly, these issues should be discussed prior to the engagement.

The turnaround specialist has a private agenda. The specialist is ultimately interested in purchasing the business, is using the business as a springboard into other ventures, or is there to maximize value to his referral source without regard to the other stakeholders. These issues with particular emphasis on independence should be addressed pre-engagement and potential conflicts should be addressed in an engagement agreement.

The turnaround specialist will not have to live with his recommendations for change and probably will not even live in the community beyond the period of the engagement. As a result, the turnaround specialist is not accountable to anyone. In reality, however, the turnaround specialist is motivated to perform the best if the troubled company is used for purposes of future references or if the company reports the results of the engagement to the referral source. The turnaround specialist's credibility and recommendations are the basis upon which lenders and trade suppliers will ultimately rely in deciding whether to offer support – and throw future business his way.

The turnaround specialist will steal ideas, techniques. If the company has proprietary property, it should legally protect itself. Otherwise, engagement agreement should cover points of privacy or proprietary content which the turnaround specialist must leave behind or be restricted through contract provisions similar to non-disclosure and non-compete agreements.

Remember to Be Cautious

Because the number of successful corporate turnarounds has been steadily increasing during the past few years, the increased visibility of the industry has attracted operators masquerading as qualified turnaround specialists. The expression "Ready, Shoot, Aim," rings all too familiar. Businesses seeking management assistance should be cautious to carefully consider each turnaround candidate.

Beware of the turnaround specialist who refuses to supply references. Since the profession is relatively young, there is limited general knowledge in the marketplace regarding the capabilities and backgrounds of turnaround specialists. Particularly, check with attorneys and CPAs with whom the turnaround specialist has worked and obtain as much specific information regarding the turnaround specialist's actual experience as possible. The TMA has implemented a Certified Turnaround Professional (CTP) designation, which checks professional and client references, and requires CTP to pass a three-part rigorous examination before qualification.

Like any professional, the competent turnaround specialist will not guarantee results whether it be a recovery, new funds, a renegotiated loan, an equity investor or buyer, or any other guaranteed result. A guarantee of any result, other than a best effort, is a signal to keep interviewing.

If the turnaround specialist makes an effort to impress the company with his particularly close relationship with banks, trade suppliers, investor, or any particular resource the business may need, investigate that particular relationship further. Make sure that the turnaround specialist has adequate independence from other sources so that he can provide the company not only with his undivided attention, but also so that the company can be comfortable that his advice and lead-

© Copyright 2010, Strategic Management Partners, Inc.

ership will be void of any possible conflicts of interest.

A turnaround specialist who tries to impress the company with a "look how much our firm has grown" sales approach is equating quantity with quality. The implication is that the firm has grown because the marketplace recognizes the quality of the work performed.

The issue of the turnaround specialist taking equity is a double-edged sword. Some turnaround specialists believe that taking equity or having an opportunity to receive an equity position with a client is a conflict of interest, which could impair their management judgment. Others believe that, as an equity holder, the turnaround specialist not only shares the risk but also must maximize shareholder value, and therefore, benefit all constituents, to receive the full compensation. This is effectively the same theory underlying stock option plans for management in many companies. Regardless of whether equity participation is good or bad, the company and the turnaround specialist should fully discuss equity participation prior to the engagement and define the potential role of equity, if any, in the engagement agreement prior to employment.

Investigate the turnaround specialist's actual experience. Ask what portion of this business has actually been in turnaround situations rather than in other executive or consulting capacities. Although the number of turnaround specialists is rather small at this time, try to avoid providing a job in transition for an executive or a training ground for a consultant.

When discussing fees, provide specifically for what expenses are to be reimbursed and the level of reimbursement generally expected. Most importantly, do not let it become either a surprise or a source of disagreement. Again, cover as much as possible prior to the engagement in a written engagement contract.

Engagement Agreements

Always insist upon a written engagement agreement to outline the terms of the engagement. Provisions that should at least be considered include:

- **The purpose of the engagement.**
- **General responsibilities of the turnaround team, the company's management and staff.**
- **Time the specialist will devote to company. (What other commitments must specialist deal with simultanously?)**
- **Specialist's staff.**
- **Company staff.**
- **Specialist's core of professional support for the business (attorneys, accounting firms, etc.).**
- **Terms of any equity opportunities for the specialist (The entire question of the turnaround specialist and equity is one of the more troublesome in this growing profession. It is critical that all parties understand the rules up front. For example: discuss equity kickers, the specialist as an equity participant, finder's fees, etc.).**
- **Term of the engagement (Define the time period of the engagement).**
- **Fee arrangement, terms of performance bonuses, payment schedule.**
- **Project "deliverables" (What the specialist is expected to deliver, even if it is only a best effort. A schedule of anticipated benchmarks where both parties may measure progress and satisfaction with the other.)**
- **Fee for acting as a broker in selling the business.**
- **Regular reporting mechanism (to assure communication between the parties.)**
- **Specialist's follow-up responsibilities after the engagement is concluded.**
- **Termination provisions (includes notification periods, for both parties.)**

Turnaround Financing For Financially Distressed Companies

While most owners of distressed businesses believe that access to more money would solve their company's financial problems, turnaround specialists recognize that the shortage of capital is often only a symptom, rather than the primary problem facing a distressed company. Although sufficient and available financial resources are necessary to implement turnaround plans, a successful turnaround must first attack and solve the business problems which produce the cash crisis.

Financing is an integral part of a troubled company's plan of reorganization. An effective financing plan will stabilize the cash position during crisis, provide necessary capital base to allow the company to return to profitability, and restructure the balance sheet so it can support the company into the future.

Financing strategies differ from situation to situation according to the liquidity and viability of the distressed business. Initially, turnaround specialists attempt to maximize the liquidity to provide sufficient time to evaluate the viability of the business. In addition, the turnaround specialist is likely to implement cost reduction plans and attempt to renegotiate the terms and covenants of existing financing arrangements to a level the company can live with during the recovery period.

When necessary, the turnaround-financing plan can involve a recapitalization, or a restructuring of the right side of the balance sheet. This involves changing the relationship between existing financial stakeholders through a combination of debt and equity conversions, exchange offers, stock rights offerings, and the addition of new financial stakeholders. Obviously, the more sever a company's situation is, the more difficult it is to work out an arrangement with existing trade creditors, lenders, equity holders, and the harder it is to attract new stakeholders.

Turnaround financing specialists provide financially distressed companies a number of financial resources and expertise to draw upon. Capital resources and the range of services differ widely among lenders, equity investors, and purchasers of securities and claims of distressed companies.

Historically, asset based lenders have been a primary source of loans to distressed businesses. These loans are often made at premium rates while the lender requires an enhanced security position. With the increasing number of Chapter 11 bankruptcies, debtor-in-possession lending departments emerged in many large commercial banks and investment banks. Debtor-in-possession loans are made to a company after it files for bankruptcy protection. To encourage these lenders to undertake the risks, the law provides a super priority status for repayment of their loans.

Actually, because of this super priority status, some companies must file a bankruptcy case to provide the lender with the level of security it seeks. Ironically, many lenders prefer the

© Copyright 2010, Strategic Management Partners, Inc.

control aspect of the bankruptcy process. Without court's protection and supervision, in a non-bankruptcy environment, these same lenders may well lend to a distressed company but with restrictive covenants and fees that may seem burdensome. In addition, taking into account the higher fees and rates - coupled with other restrictions to be anticipated in a distressed situation - management flexibility is limited and higher interest rates often slow the recovery. Therefore, the turnaround-financing plan is only effective if viewed on a long-term basis, and if it ultimately helps the company achieve recovery.

When a distressed company is unable to find a suitable lender, management should consider ***turnaround equity investors*** who will infuse equity capital into the business. As one would anticipate, equity funds are also an expensive alternative. Equity investors typically require a controlling interest in the company in exchange for their capital and in consideration of the abnormal risk. Equity investors often specialize in particular industries, company sizes, investment minimums and maximums, and anticipate varying management roles. Since investors bring different capabilities to the table, management should determine whether the company would best be served by financial or strategic assistance.

Financial investors sometimes have turnaround management and bankruptcy experience and are able to assist management through the complexities of the reorganization process. Investments are often made at a significant discount compared to the business's underlying asset value. While most financial investors remain involved only at the board of director level, they occasionally fill top management positions if necessary to protect their investment.

While some financial equity investors have funds committed and immediately available, others act as financial intermediaries receiving an equity position in the company as their compensation upon completion of the investment. These investors act as a "gate keeper" between the financially distressed company and the alternative ***sources*** of financing. While many financial intermediaries are skilled financial advisors and have a wide network, management should be aware of possible conflicts of interest between the advice they receive from the financial intermediary and his compensation arrangement. Full disclosure should be sought to assure that the primary motivation for putting the deal together is not the fee involved.

Alternatively, ***strategic equity investors*** are identified by their specific industry or geographic requirements and generally provide specialized experience and knowledge with their investment. These investors often acquire financially distressed companies to consolidate with their existing companies and typically become involved in the management of the acquired business at a senior operating level. Since the passage of time usually works against a financially distressed company, the strategic investor may provide the company with a more timely, or occasionally, the only solution.

Regardless of the type of equity investor, the financially distressed company will often benefit from the increased negotiating leverage with its constituencies that a credible new investor brings to the turnaround. Once new equity funds are infused into the business, the company's existing lender may be more willing to modify the loan agreement if they feel that their loan is protected from further impairment. Trade creditors may agree to credit terms more favorable to the troubled business if they believe that future payments have become more certain and if no trade creditors are being preferred over others. A local government may be more willing to provide tax concessions and financing if it believes jobs will be saved so that the business can continue to contribute positively to the local economy. Of equal importance, employees may be more willing to consent to concessions if they believe that the company's survival is at stake, that their jobs are in jeopardy, and that they are an integral part of the recovery process.

Purchasers of securities and claims of financially distressed companies do not infuse capital directly into the business. However, management should be aware that these investors can have a tremendous impact on the company's turnaround efforts through their purchase of securities and claims from the existing financial stakeholders. Investments are typically made in company's debt, since in a bankruptcy, debtholders have a higher priority status than equity holders and are able to influence management's reorganization efforts through participation on the creditors' committee. In some cases, these investors will infuse equity capital into the business as part of the plan of reorganization to increase the returns on their investments.

This growing number of investors look for opportunities to purchase securities and claims at significant discounts from financial stakeholders who prefer immediate liquidity rather than the uncertainty of recouping their investment over the long term. They believe that their investments will yield considerable returns upon the successful reorganization of the financially distressed business.

Experienced turnaround specialists have networks to assist their clients to find the funds necessary to fuel the recovery.

A Final Word of Advice...

Do Not Expect Miracles Overnight.

The turnaround can take years of hard work to achieve, the turnaround specialist can only be a catalyst to change. Owners must make hard decisions enabling the process to take place.

Ultimately, success of a turnaround rests upon the shoulders of a business' most valuable assets, albeit not shown on any balance sheet: its turnaround leadership, its owners and lenders, its management and its employees all dedicated to turning around the company. It is upon their effort, performance, credibility, and commitment that the turnaround specialists, lenders and creditors, and the marketplace, ultimately rely. **abfj**

John M. Collard, is Chairman of Annapolis, MD-based Strategic Management Partners, Inc., a nationally recognized turnaround management firm specializing in interim executive leadership and investing in underperforming companies. He is Past Chairman of the Turnaround Management Association, a Certified Turnaround Professional, and brings 35 years senior operating leadership,

$85 million asset recovery, 40-plus transactions worth $780 million, and $80 million fund management expertise to advise company boards, litigators, institutional and private equity investors. Collard can be reached at 410-263-9100. Or, for more information, visit www.StrategicMgtPartners.com

© Copyright 2010, Strategic Management Partners, Inc.

MANAGE
YOUR
RISK

iNDIVIDUALS. iDEAS. iNFORMATION. **on GROWTH**

deathbed businesses

WHEN A BUSINESS STOPS GROWING. IT STARTS DYING.

BY JOHN M. COLLARD

Too often, companies die unnecessarily because most business leaders haven't learned to recognize the symptoms of oncoming illness in their business. Leadership hasn't had to deal with it in the past and is ill equipped when trouble sets in. ▪ The obvious signs of business trouble are rarely its root causes. Losing money, for example, isn't the problem; losing money is the result of other problems. The astute CEO recognizes his infallibility and has the foresight to ask for help – before serious trouble sets in. ▪ If you can answer yes to some of these questions, it is time to take decisive action.

ARE YOU OVER EXTENDED?

Whose work are you doing? When the CEO continues to perform functions that should be done by others (once the business has grown to a more complex level), you are over extended. CEOs need to delegate work appropriately. Define the owner's and key managers' jobs to clarify role responsibility. Assess subordinates' competence; retain them if appropriate and replace them if not. Monitor key metrics so you'll remain informed about conditions, without being immersed in them.

IS TURNOVER EXCESSIVE?

A sure sign of underlying problems is rapid employee turnover. Employees know when problems exist, and the good ones will leave early. The price for ignoring this problem is high: low morale, lost wages, recruiting costs, lack of productivity, and ultimately, forfeited business.

Uncover the real causes early on, and rectify them. Solutions include clearly defined job responsibilities, performance expectations, rewards and scope of authority. Several levels of management attention should be devoted to new key employees (and those moving to new positions) during the initial days of their assignment.

ARE GOALS UNCLEAR?

Chronic failure to achieve stated business goals suggests a problem far more serious than a lack of performance. Often, it implies a lack of clarity regarding your goals, and usually indicates a failure to secure management team buy in.

Take a long, hard look at the goal setting process. Set goals and hold managers accountable for success.

ARE INCENTIVE PROGRAMS YIELDING POOR RESULTS?

While it seems obvious that programs should clearly and directly reward successful job performance, it's remarkable that many companies unwittingly set up compensation structures that reward performance altogether different from that outlined in the job description. A word of warning if this is your practice: be careful what you pay for — you might just get it.

IS NEW BUSINESS WANING?

If so, you are out of touch with the marketplace. High prices, unresponsive proposals and giving more than is required of you are the typical reason companies lose bids. Commitment to winning new business is essential to success; so identify targets early on, always keeping a close eye on the customer's special needs. Bid to win, and then manage for profit and growth.

ARE KEY CLIENT RELATIONSHIPS DETERIORATING?

Determine if a decrease in business from long-time customers is due to poor market conditions in their industry, or poor service from your company. If it's you, you're probably no longer meeting the customer's needs. Worse, you may not know.

Manage customer relationships carefully. Customer needs, like your own, change. Assign specific responsibility for nurturing customer relationships to all levels of management, not just to those within the sales force.

DO YOU CREATE PRODUCTS IN SEARCH OF MARKETS?

Products developed before market needs are assessed can waste resources and be difficult to sell. It is less expensive to create awareness of a product or service that meets an existing demand than to develop a new market for existing products or services that doesn't exist.

DO YOU HAVE FAILED EXPANSION PLANS?

Setbacks drain businesses of cash, time, and morale. When companies fail in one effort, management tends to pull in its horns the next time out. The result? Suppressed hopes for growth or expansion. Efforts fail because of inadequate cash, poor management, lack of thorough market analysis or improper control systems.

ARE COMMUNICATIONS INEFFECTIVE?

Ineffective meetings, management information, or inter departmental coordination can destroy a business from the inside out, even as it is growing.

If all that you accomplish during "Bull Sessions" is a lot of "Bull" it is clearly the fault of the leader. It's a leader's duty to limit the scope of participants and topics discussed and to establish an agenda — with specific begin and adjourn times — and stick to it. Demonstrate organization by managing your meetings and your team will demonstrate that organization by managing your company.

John M. Collard is Chairman of Annapolis Maryland-based Strategic Management Partners, Inc., a nationally recognized turnaround management firm specializing in interim executive leadership, asset recovery, investing in underperforming distressed troubled companies. (410) 263-9100 www.StrategicMgtPartners.com

© Copyright 2010, Strategic Management Partners, Inc.

iNDIVIDUALS. iDEAS. iNFORMATION. on GROWTH

deathbed businesses

WHEN A BUSINESS STOPS GROWING. IT STARTS DYING.

BY JOHN M. COLLARD

Too often, companies die unnecessarily because most business leaders haven't learned to recognize the symptoms of oncoming illness in their business. Leadership hasn't had to deal with it in the past and is ill equipped when trouble sets in. ▪ The obvious signs of business trouble are rarely its root causes. Losing money, for example, isn't the problem; losing money is the result of other problems. The astute CEO recognizes his infallibility and has the foresight to ask for help – before serious trouble sets in. ▪ If you can answer yes to some of these questions, it is time to take decisive action.

ARE YOU OVER EXTENDED?

Whose work are you doing? When the CEO continues to perform functions that should be done by others (once the business has grown to a more complex level), you are over extended. CEOs need to delegate work appropriately. Define the owner's and key managers' jobs to clarify role responsibility. Assess subordinates' competence; retain them if appropriate and replace them if not. Monitor key metrics so you'll remain informed about conditions, without being immersed in them.

IS TURNOVER EXCESSIVE?

A sure sign of underlying problems is rapid employee turnover. Employees know when problems exist, and the good ones will leave early. The price for ignoring this problem is high: low morale, lost wages, recruiting costs, lack of productivity, and ultimately, forfeited business.

Uncover the real causes early on, and rectify them. Solutions include clearly defined job responsibilities, performance expectations, rewards and scope of authority. Several levels of management attention should be devoted to new key employees (and those moving to new positions) during the initial days of their assignment.

ARE GOALS UNCLEAR?

Chronic failure to achieve stated business goals suggests a problem far more serious than a lack of performance. Often, it implies a lack of clarity regarding your goals, and usually indicates a failure to secure management team buy in.

Take a long, hard look at the goal setting process. Set goals and hold managers accountable for success.

ARE INCENTIVE PROGRAMS YIELDING POOR RESULTS?

While it seems obvious that programs should clearly and directly reward successful job performance, it's remarkable that many companies unwittingly set up compensation structures that reward performance altogether different from that outlined in the job description. A word of warning if this is your practice: be careful what you pay for — you might just get it.

IS NEW BUSINESS WANING?

If so, you are out of touch with the marketplace. High prices, unresponsive proposals and giving more than is required of you are the typical reason companies lose bids. Commitment to winning new business is essential to success; so identify targets early on, always keeping a close eye on the customer's special needs. Bid to win, and then manage for profit and growth.

ARE KEY CLIENT RELATIONSHIPS DETERIORATING?

Determine if a decrease in business from long-time customers is due to poor market conditions in their industry, or poor service from your company. If it's you, you're probably no longer meeting the customer's needs. Worse, you may not know.

Manage customer relationships carefully. Customer needs, like your own, change. Assign specific responsibility for nurturing customer relationships to all levels of management, not just to those within the sales force.

DO YOU CREATE PRODUCTS IN SEARCH OF MARKETS?

Products developed before market needs are assessed can waste resources and be difficult to sell. It is less expensive to create awareness of a product or service that meets an existing demand than to develop a new market for existing products or services that doesn't exist.

DO YOU HAVE FAILED EXPANSION PLANS?

Setbacks drain businesses of cash, time, and morale. When companies fail in one effort, management tends to pull in its horns the next time out. The result? Suppressed hopes for growth or expansion. Efforts fail because of inadequate cash, poor management, lack of thorough market analysis or improper control systems.

ARE COMMUNICATIONS INEFFECTIVE?

Ineffective meetings, management information, or inter departmental coordination can destroy a business from the inside out, even as it is growing.

If all that you accomplish during "Bull Sessions" is a lot of "Bull" it is clearly the fault of the leader. It's a leader's duty to limit the scope of participants and topics discussed and to establish an agenda — with specific begin and adjourn times — and stick to it. Demonstrate organization by managing your meetings and your team will demonstrate that organization by managing your company.

John M. Collard is Chairman of Annapolis Maryland-based Strategic Management Partners, Inc., a nationally recognized turnaround management firm specializing in interim executive leadership, asset recovery, investing in underperforming distressed troubled companies. (410) 263-9100 www.StrategicMgtPartners.com

www.SmartCEO.com December 2007 Washington SmartCEO

THE CORPORATE BOARD

THE JOURNAL OF CORPORATE GOVERNANCE

Is Your Company In Trouble?

By John M. Collard

When a company faces financial ruin, more than corporate pride is on the line. Lenders, creditors and shareholders can lose their investment; employees can lose their livelihood; and the reputations of the board and top management can be permanently tarnished. Much of this can be avoided if board members aggressively monitor the overall health of the company they are obliged to advise. What are the early signs of impending disaster? How do boards best respond?

When a company is headed for trouble, all stakeholders share the added risk. Directors, however, face added accountability. Courts are stepping in and evaluating a board's performance -- and asking for recompense in cases of corporate failure.

Board members accept this added burden when they sign up for duty. The way the board as a whole, and its individual board members, respond will face close scrutiny should the company fail. Directors are wise to watch for the first signs of corporate trouble, and must be willing to act in fulfilling their fiduciary responsibilities to the company and its shareholders.

Board denial of management problems too often renders directors unable to recognize key warning signs. Astute directors and managers will watch for these early indicators of trouble.

Directors and top management are often aware that problems exist, yet they delay in correcting the problems. Excuses become easier to generate rather than the hard work it takes to bootstrap a failing company back to financial health.

This denial is often veiled in stubborn corporate pride. Yet it renders board members and even upper management unable to recognize the key warning signs that suggest a company is on its way toward trouble.

By the time a company is visibly sliding toward financial ruin, management can do very little to save face. It is at this time (if not before) that directors need to step in and take control of the situation before management allows the company to utterly collapse. This could well be the last time directors can have a measurable impact on the future of the company.

There are ten common early warning signs that mark a company heading for trouble. Astute directors and managers will use these to gauge overall corporate health and management team effectiveness. If, as a board member, you can answer yes to any of these questions, there is trouble on the horizon. The time to act is now, before problems grow out of hand.

■ ***Is top management over-extended?*** Whose work is top management really performing? When top managers continue to perform functions that should be done by others, they are over-extended. CEOs should perform work for which no one else is as qualified.

Also ask if top executives are managing the areas necessary and critical to meet corporate goals. Or, are they managing tasks that have little impact on goals? Many managers focus on tasks with which they are familiar and avoid potentially career-ruining risks that are needed for vibrant corporate growth.

Delegation is the key to dealing with over-extension. Define key managers' jobs to clarify role responsibility. Assess subordinates' competence; retain them if appropriate, replace them if not. Monitor key metrics so you will remain informed about conditions without being immersed in them.

Experienced directors know that financials do not show you how to run the business. Consider instead two areas: On the Volume In (revenue/sales) side, look at where and how revenue is generated. Is it from existing customers and contracts or new business? On the Volume Out (throughput/production) side, look at getting the product or service out the door. How else can you bill for it?

■ ***Is the turnover rate excessive?*** A sure sign of underlying problems is rapid employee turnover. This can be the result of such failings as a faulty hiring process, inadequate training, or poor management. The price for ignoring this problem is high -- low morale, lost wages, recruiting costs, lack of productivity, and ultimately, failure.

You must uncover the real causes of rapid turnover early on, and rectify the problems. Clearly define job responsibilities, performance expectations, rewards, and scope of authority. Concentrate several levels of management attention on new employees. Talk to employees, but more importantly, listen to what they say. Be assured, employees know when problems exist.

In one troubled company, neither the senior management team nor heads of the operating units had any idea how to deal with a 40 percent yearly turnover rate. One manager did not even know his group's revenues.

Once, during a client planning session with several major stockholders, board members, and the entire senior management team present, I was astounded to hear that they had no approach to control a turnover rate exceeding 40 percent per year. I asked the managers of the three operating units to discuss the revenues in their units and turnover rates so we could isolate a problem. To the chagrin of the chairman and CEO, one manager did not know the revenue figure for his group. None of the three, nor the human resources vice president knew the number of employees lost in the previous year.

In a $70 million company, when management does not know such things, you have uncovered a key problem, as well as the cause for other problems. By acknowledging that the problem exists, you empower both the board and management to do something about it.

■ ***Are communications ineffective?*** Ineffective meetings, management information, or inter-departmental coordination can destroy a business from the inside out -- even as it is growing. The larger a company becomes the more this is a problem.

If all that is accomplished during "bull sessions" is a lot of "bull," then the blame rests squarely on the shoulders of the meeting leader. It is a leader's duty to limit the scope of topics discussed, to establish an agenda, and stick to it. Do not allow corporate posturing to waste time and productivity. Force corporate leadership to demonstrate organization by managing their meetings.

Remember, what is not said is often more destructive than what is. Unnatural behavior, such as a rash of "closed door meetings," will most certainly set off the rumor mill. Level with employees.

■ ***Are compensation and incentive programs yielding unsatisfactory results?*** While it seems obvious that you should clearly and directly reward successful job performance, it is remarkable that many companies unwittingly set up pay structures that reward performance altogether different from that outlined in the job description. Be careful what you pay for -- you might just get it.

One client paid dearly for such a system. They operated in a matrix organization, four selling divisions and a central support operation. The manager of professional support personnel was on an incentive plan based on 80 percent utilization of labor in the pool. The good people were always used while the poor performers were not. Sales required that more acceptable support be available for billable customer contract requirements, yet the manager did not hire to replace poor performers because that could change the utilization rate. The result was lost revenue opportunity, added carrying costs for nonperformers and a failure to meet company goals. The manager achieved his numbers, received his bonus and was relieved of his responsibility.

Managers who are paid incentives based upon gross margins can be more effective than those paid on gross sales. Why? Because they share the burden of poor performance, they are more likely to take corrective action when faced with substandard performers. The board sits in the best position of all to restructure pay systems.

Restructuring rewards requires planning. Pay-for-performance systems should be tied directly to the company's plan. Pay for execution and stellar performance, nothing less. It is up to the board to set the directives and goals, and leave it to the management team dedicated to reviving the company to

John M. Collard is Chairman of Strategic Management Partners, Inc, Annapolis, Maryland-based turnaround and transition management specialists, and equity capital investors. He is Past Chairman of the Turnaround Management Association, a frequent author and speaker.
(410) 263-9100 ▪ www.StrategicMgtPartners.com ▪ Strategic Management Partners

© Copyright 2010, Strategic Management Partners, Inc.

make the incentive structure work.

Public companies often send the wrong message when top performers bring in the big deals. They balk at the amount promised in the incentive plan, perhaps because this is more than the boss makes. If you pay the large amount and make sure that all are aware of it, then this becomes a true incentive for the whole sales force.

■ ***Are goals not clearly stated?*** Chronic failure to achieve stated business goals suggests a problem more serious than a lack of performance. Often, it implies a lack of clarity regarding the goals of the corporation. The goals of the shareholders, the board and the management team must all be in sync. Failure to achieve business goals also indicates a failure to secure management team "buy in."

What is the company's real goal? Most corporate goals do not say anything. Remember your ultimate goal to make money. If you do not remember it, rest assured, your stockholders will.

Focus on the one thing the company does very well. You can manifest that focus in many ways, but do not confuse manifestation with diversification.

Take a long, hard look at the goal-setting process. Set goals and hold managers accountable for success. Goals must be clearly articulated and agreed upon. If you cannot step back and be a skeptic, the goals have no substance.

What is the company's goal? The mission statement should state this clearly. What usually comes through is ". . . we are the best at providing a lot to everybody . . ." which does not say anything. Set a mission statement that tells customers, employees, and stockholders where the company is headed. If it cannot be articulated, does it really exist? A good mission statement should address six elements:

- Service/product definition -- what do we do or provide?
- Generic customer need -- why will they buy?
- Market definition -- who will we sell to and where are they?
- Technology -- how will we deliver our products and services?
- Levels of vertical integration -- how much will we do?
- Distinct competence -- why will they buy from us?

Most companies are too generic in their definition, but competition dictates that you focus. Do not underestimate the importance of your key competencies, those strengths which no one else has. The board can help with realism. Too many companies allow complacency to lull them into a false sense of what the market wants. Identify goals that are in sync with these strengths. Remember the ultimate goal -- companies are in this for the money. If you do not remember, your stockholders will.

Avoid the pitfall many companies experience -- the strategic and operational planning process produces a plan, which sits on the shelf gathering dust until the next cycle. Measurement against plans and resulting course correction should be a continuous process. Most of the gain is in the process.

■ ***Is new business waning?*** If the operation cannot win new business at expected levels, it is out of touch with the marketplace. High prices, unresponsive proposals, giving more than is required of you are the typical problems.

Commitment to winning new business is essential to corporate success, so it is crucial to identify targets early on and tailor specifications whenever possible. Always keep a close eye on the customer's special needs. Bid to win, but then manage for profit and growth. Develop a "we will do what it takes" attitude toward developing new business.

■ ***Are any key client relationships deteriorating?*** Determine if a decrease in business from long-time customers is due to poor market conditions in their industry -- or poor service from you. If it is you, the corporation is probably no longer meeting the customer's needs. Members of the board may not be privy to this information.

Manage customer relationships carefully. Customer needs, like your own, change. Give specific responsibility for nurturing customer relationships to all levels of management, not just to those within the sales force. You will need to have faith in those in the company who can reach out and talk with the customer. Few customers will call to tell you that they are not going to buy your product any more, they just stop writing checks.

Consultants avoid this subject like a plague, because it is controversial and hard to pin down; however, this is where the board and consultants can really help with strategy to nurture management commitment and involvement. Address the real issue of how customers perceive the company and its products and services relative to competition. Do not be lulled into a false sense of security. Those customers will not always be there.

■ ***Does the company create "products in search of markets?"*** Markets and competitors must be properly analyzed. Disciplined self-analysis is needed. Products or services developed before market needs are assessed can waste resources and be difficult to sell.

It is less expensive to create awareness of a product or service that meets an existing demand, than to develop a market for products or services that does not currently exist. Identify how your key competencies satisfy customer need and produce benefits.

■ ***Do financial and management reports cover the wrong information at the wrong levels?*** Financial and operational reports must be accurate, timely and pertinent. Many businesses are managed on a profit and loss or earnings per share performance basis, rather than on the basis of cash flow or new business generated. A few key symptoms for which the board should watch: Financial statements are consistently late; recurring negative cash flow; constant bickering with or change of outside auditors; excessive year-end adjustments; focus on what happened rather than what is needed to fix it.

Does the board ask for specific reporting to measure key areas of risk within the company? They should. Often, standard reporting is not sufficient.

Cash flow remains the best indicator of business health. Information is often prepared at wrong level, making it difficult or impossible for the board to know what is going on inside their operations. Prepare forecasts, then manage to them. Determine performance at each level of the business, and update often.

Understand why the company is successful in its present bright areas, and 'model' those conditions to a new marketplace.

■ ***Does the operation have a track record of failed expansion plans?*** Setbacks drain businesses of cash, time and morale. When companies fail in one effort, management tends to 'pull in their horns' the next time out. The result --suppressed hopes for growth or expansion. Efforts fail because of inadequate cash, poor management, lack of thorough market analysis, or improper control systems.

Anyone who runs independent or remote operations must be adept at problem solving, decision making, team building, and managerial analysis. Yet these skills are not obvious, and though expected of managers, are seldom part of the recruiting or management development process.

Understand why you are successful in your present marketplace, and try to 'model' those conditions in a new marketplace. Modeling success can produce growth. The entrepreneurial spirit craves growth, but desire alone can drive the company only so far, and often into trouble. By modeling management skills, you can adapt to new management environments and bypass mistakes that can harm the bottom line.

Learning to look for the first signs of trouble takes little more than a willingness to truly commit yourself to productive board service, and to proper corporate management. The signs are not always neon and blinking, but they are there, if you care to look for them.

Likewise, the solutions are not difficult to find, and do not require magic, if you have the appropriate management team in the driver's seat. If misery likes company, then 'trouble' loves it -- problems can multiply at a frightening speed.

To whom should a director turn for help during times of crisis? Diminishing sales, declining profits, mass employee exit, creditor suits, the threat of bank foreclosure, and no cash are only part of the equation. These problems can be repaired. The true dilemma -- who can handle the crisis management role? Clear thinking must prevail. If there is a qualified leader within the company, then delegate the job of turnaround to them, and provide proper support. If there is not a qualified leader in the company, and there usually is not, do not hesitate to locate a professional who has experience restoring value to a troubled company. The answer often resides outside the company in the form of a corporate renewal or turnaround specialist, who has expertise in the company's lines of business.

Consultants are often a choice of the management team. Why? Because as an advisor, they offer only recommendations to management. Yet these are the same managers that did not make decisions in the first place. Why will they make those decisions now?

The board must also be willing to ask "are we the problem?" If the board is in a position to act, the management is not doing what is required of it.

The board can change this charade at management. Here is definitely an area where the board can make a difference. Corporate renewal practitioners work with the board, and top management, the way auditors work with a comptroller and the way lawyers work with management. The practitioner is a hands-on decision maker who actually takes control of the company, often as an interim CEO for a period of time. To be effective in turning a troubled company around, this person must have an active line manager orientation, be decisive, isolate the problems and find solutions quickly.

Also, the board must be willing to ask "are we the problem?" Many times the answer is yes. The board is not in step with goals or with the management team. They do not get involved or they overlook the signs of pending crisis.

If the board is in a position to act, then the present management has not done what is required of them. The board must find a leader that can work for the benefit of all stakeholders.

The real focus should be to change the leadership style. Leadership requirements differ between healthy, growing companies and those in trouble. These differences in style are a key to success. The board must decide which style is needed, then act on that decision. In the stable or growth scenario, "team building" and "coaching" are the buzzwords. But in the initial crisis and subsequent turnaround situation, time is an enemy, and decisive action is mandatory.

This is one reason why the troubled environment is so foreign to many managers, and hence, the difficulty finding qualified talent from within the company. The stable environment allows for mistakes and longer lead times to achieve goals. Troubled companies have primarily one goal -- to survive and get well. If the symptoms persist with no cure, the patient dies.

Only in acting on what is best for true corporate health will the board completely fulfill its fiduciary responsibilities. There is one critical question every board member should ask himself or herself: "Can I stand before a bankruptcy judge, before a creditor's committee, before a shareholders meeting and defend with pride and conviction the path I have allowed this company to follow?"

One thing is certain: The longer you wait to admit that the company is heading for trouble, the more difficult the resulting problems will be to solve. Mastering the real issues is the catalyst toward change, and recovery. That is a much more acceptable risk. ■

Reprinted with permission. The Corporate Board, The Journal of Corporate

SPECIAL Turnaround Management Issue

The Journal of PRIVATE EQUITY

Strategies and Techniques for Venture Investing

VOLUME 5, NUMBER 4 www.iijpe.com FALL 2002

Steering Clear of the Brink:

Early Warning Signs Pinpoint Business Troubles — Changing Leadership Style to Accomplish a Turnaround

John M. Collard

Whether you are an investor, serve on a board of directors, own or manage a company, you face business risks. All of the stakeholders accept additional risk when the company is heading for trouble. Balancing these risks can cause a predicament. By recognizing some early warning signs that indicate business trouble on the horizon, you can eliminate, overcome, or, at the very least, side step many of those risks.

Business trouble means different things to each of us at different times. The perception differs depending on the stakeholder, but the fear is always the same — loss of their investment (money, time, energy, good will, reputation). The anticipation of loss is unacceptable. No one likes to lose — anything.

Lenders, creditors, and shareholders may lose their investment. Owners can face financial ruin, disgrace, or humiliation. But worst of all, the employees have the most to lose. They can lose a life force, their income, and have little to say over the decisions that impacted that loss. In these times of miserable job climate, stubborn economic recovery, and uncertain accounting practices, this loss can be the most devastating.

Top management is often aware that problems exist. The 'trouble' is, they wait too long to do anything about them. Why? Perhaps it's hope. 'Things will get better soon.' Perchance it's naiveté: 'Management doesn't know how to manage in this situation.' Maybe it's guilt: 'If I'd been a better manager, I wouldn't be facing failure in the first place.' Perhaps it's Founders Syndrome: The owner believes that only they, can run the company. But what is the most dangerous trouble of all? Denial [not the river in Egypt]. Denial makes owners or managers unwilling to admit that problems even exist. Or worse . . . it can blind them to the very problems that are heading their companies toward sure demise. Here's the bottom line: The longer it takes to get necessary help, the harder it will be to relieve the trouble and the more risk you assume.

When a company is in trouble, the rules change. Management is often 'out of its element;' it is entering untrodden ground. People haven't had to manage in this environment before. Why will they succeed now? The odds are that they will, at the very least, have difficulty.

Time and again, the obvious signs of business trouble are rarely its root causes. Losing money, for example, isn't the problem. Rather, losing money is the result of other problems. Diminishing sales, declining profits, mass employee exit, creditor suits, the threat of bank foreclosure, and no cash are only part of the equation. These problems can be repaired. The true dilemma becomes, who can handle the crisis management role?

ALL LEADERS ARE NOT CREATED EQUAL

To save the company you must change the style of leadership to affect change. Clear thinking must prevail and a special set of skills must be applied.

If there is a qualified leader within the company, then delegate the job of turnaround to them, and provide proper support. If there is not a qualified leader in the company, and there usually isn't, don't hesitate to locate a professional at this type of work.

Contrasting Leadership Styles

Skill	Stable, Healthy or Growth Scenario	Troubled or Turnaround Situation
Focus	On Objectives	Survival, action, problem-solving
Decision making	Deliberate	Decisive, Immediate
Authority	Delegate	Direct Involvement
People	Develop	Recruit talent/Communications
Respected for:	Management reputation	Financial credibility
Known for:	Consistency	Ability to shift gears

Let's put this leadership role into proper perspective. Leadership requirements differ between those for healthy, growing companies and for those in a troubled situation. The CEO that managed the company into trouble clearly is lacking the skills to doctor it back to health.

Differences in style are a key to success, in either situation. In the growth scenario, team building and coaching are buzzwords. But in the initial crisis and subsequent turnaround situation, *time is an enemy*. Decisive action is required.

The focus is dramatically different. This is one reason why the troubled environment is so foreign to many managers, and hence, the difficulty finding qualified talent from within the company. The stable environment allows for mistakes and longer lead cycles to achieve goals. Troubled companies have one goal — to survive and get well. If the symptoms persist with no cure, the patient can die.

> "When it rains, it pours" may be clichéd, but when applied to a troubled company, one can be sure that "Murphy is shaking the clouds."

Companies often get into trouble because management procrastinates when it comes to making decisions. If the decision is made by default, it is akin to making no decision at all. Much of that early, and overall, survival also depends upon being immediate — upon making decisions in a timely manner. Even a wrong decision means movement and direction. If a decision turns out to be wrong, change it, but keep things moving.

Just as with a critical patient, the immediate focus at a troubled company should be on action — make something happen. The first goal in absolute crisis is to stabilize and buy time. After calming the waters, take a reading on where things stand — which is normally still. Look for changes in ratios and trends to determine *what is*, or more importantly, *what is not* going on in the business.

Time is also an important dimension when it comes to authority. In a stable company, there is time to delegate and nurture the growth of the management team; time to work on long term issues and projects. In the troubled situation delegating takes on a different role. Managers must be held accountable not only for performance, but for timely results.

In a troubled situation, the decision maker must get directly involved. It is hard to worry about the long-term future when there may not be one. The leader is pressed closer to the immediacy of day-to-day operations. If you want action, request a decision . . . or make one.

In a stable situation there is time to develop talent. But when in trouble, remember that the good managers may have deserted the ship long ago, leaving behind the second string. You must exploit the talents of those employees that remain who can perform and bring them to new levels, then recruit talent that is lacking. It means building permanent management teams that can bring the company back to health — and add value to the company.

Communication is critical — with everyone who has a stake in the company's success. Talk to employees, but more importantly; listen to what they have to say. Be assured, they know where problems exist, and often have solutions.

A key element to a successful turnaround is to establish a good relationship with your lender. Capital is always required in tough times, not to mention that it's nice to have in good times as well.

If the leaders who were in power while the company's position was allowed to deteriorate are still there, why should the lender believe that they would now be instrumental in correcting the situation?

To make matters worse, in the eyes of management, the lender is often viewed as an enemy instead of a key part of the turnaround equation. With all the suspicion that can surround a troubled company, it is important that trust be re-established with the bank. Credibility with the lenders is mandatory to success — and to keeping that cash flow at the bank. Since the bank holds the trump card, the institution must feel comfortable working with the turnaround leader. It means laying everything out on the table to keep the situation honest — and honoring commitments made to the lender.

Where consistency is important in a stable environment the name of the game in a turnaround situation is uncertainty. You can absolutely, positively count on surprises. "When it rains, it pours" may be clichéd, but when applied to a troubled company, one can be sure that "Murphy is shaking the clouds."

The ability to deal with change at a rapid pace is essential. This is why a seasoned practitioner can be the answer to a successful turnaround plan, they've "been there, done that."

THE PROCESS

Along with specific skills and an understanding of troubled situations, the specialist offers a new perspective from which to independently evaluate the company's circumstances. The process will focus on several issues:

- Is the business viable?
- What is the purpose of the business?
- Should it be saved? Why? Are those reasons valid?
- Is there a core business that can be the source for the emerging business?
- Are there sufficient cash resources to fuel the recovery?
- Which existing managers are capable of leading parts of the company?

Remember, not all companies are salvageable.

The fact-finding must proceed as quickly as possible so that a realistic assessment of the current state of the company can be prepared. The specialist's first priority will be to manage cash flow — to stop the hemorrhage. Analysis of sales and profit centers, and asset utilization should indicate where the real problems — not the symptoms — are located. Next, a business plan outlining and suggesting possible courses of action — or cures — will be prepared.

Following this diagnostic stage, the transition can begin towards a turnaround. Most importantly, the leader needs to get things moving again. Once the course of action is chosen, implementation and monitoring can occur. The specialist should remain involved at least until the business is stabilized, and preferably until the transformation is complete and a new "Marquis" leader is found.

© Copyright 2010, Strategic Management Partners, Inc.

WHO CAN HELP THESE BESIEGED BUSINESSES?

Turnaround specialists generally are either interim managers or consultants. These leaders didn't start out as such — they were often managers that worked their way up the corporate ladder through hard work and (hopefully) fair play to build a solid management reputation. They have developed a set of skills to handle problem solving, getting results with minimal resources, (tight) cash flow management, negotiating and dealing with bankers, investors and creditors. The stakeholders will usually work with a turnaround leader — if he/ she is credible.

Consultants are often a choice of the management team. Why? Because they are an advisor, they offer recommendations to management. Often the same management that guided the company into trouble in the first place. Why will they make those decisions now? Why risk allowing the same person to try again? Whether a consultant is effective depends upon management's willingness to *listen* and *implement* the specialist's recommendations.

Practitioners, by contrast, are hands-on decision makers who actually take control—often as CEO—for a period of time. They are in control of the company's destiny, take decision-making reins, plot the course, and Steer the company through troubled waters, hopefully to safety. They must have an active line manager orientation, be decisive, isolate problems and find solutions quickly.

Be assured there are countless cases where existing management agreed to work with a turnaround consultant only to placate the board or the lender. There is no substitute for qualified leaders with decision-making authority.

When hiring a turnaround specialist:

- Check references.
- Review proposals versus what can realistically be accomplished.
- Require engagement agreements.
- Hire an individual, not the firm - personal chemistry with the managers is critical.

A good practitioner has three goals; 1) get control, stabilize the situation, jump-start the turnaround, 2) develop and implement a sound plan, and 3) hire their permanent replacement, while working themselves out of a job.

EARLY WARNING SIGNS

Too often, companies die unnecessarily. Why? Because, most leaders and haven't learned to recognize the symptoms of oncoming illness in their business.

When you wait too long to recognize deteriorating characteristics the company seeks bankruptcy protection . . . only attorneys and accountants benefit from this process. It's the astute lender or manager that recognizes infallibility, and has the foresight to ask for help . . . before serious trouble sets in.

Here are ten common signs that a company is heading for trouble. Carefully consider whether or not they apply. If you can answer *yes* to some of these questions, it is time to take decisive action.

Is the owner or top management over extended? Whose work are they doing? When they continue to perform functions that should be done by others (once the business has grown to a more complex level), they're over extended. They should do the work for which no one else is qualified.

Managers need to delegate work appropriately. Define the owner's and key managers' jobs to clarify role responsibility. Assess subordinates' competence; retain them if appropriate — replace them if not. Monitor key metrics so you'll remain informed about conditions . . . without being immersed in them.

Relationships of how numbers behave tell the real story. The balance sheet is only a snapshot in time (what you have, what you will receive, and what you owe). The income statement indicates what happened during a given period. The source and use statement shows where cash went in and out.

But these financials don't indicate how to run the business. Movement must occur in two areas — on the *volume in* (revenue/sales) side, look at where and how revenue is generated. Is it from existing customers and contracts or new business? Most importantly, keep it coming in. On the *volume out* (throughput/ production) side, look at getting the product or service 'out the door'. How else can you bill for it?

Is the turnover rate excessive? A sure sign of underlying problems is rapid employee turnover. Employees know when problems exist, the good ones will leave early. This condition can be the result of a faulty hiring process, inadequate training, poor management . . . the list goes on. The price for ignoring this problem is high: low morale, lost wages, recruiting costs, lack of productivity, and ultimately, forfeited business.

Uncover the real causes early on, and rectify them. Solutions include clearly defined job responsibilities, performance expectations, rewards, and the scope of authority. Several levels of management attention should be devoted to new key employees (and to those moving into new positions) during the initial days of their assignment.

As an example, during a client company [annual revenue at $58 million] planning session with the owner and entire management team present, I was astounded at their approach to a turnover rate in excess of 40 percent per year. The three operating unit managers were asked to discuss their unit's revenue recognition and turnover rate. To the chagrin of the CEO, one manager did not know the revenue figure for his group, and none of the three, nor the human resources manager, could recite the number of employees lost in the previous year. When management doesn't know, you have uncovered one real cause for problems. You first have to acknowledge that a problem exists, look for the cause(s), then do something — identification alone is not enough.

Are communications ineffective? Ineffective meetings, management information, or inter departmental coordination can destroy a business from the inside out — even as it is growing.

If all that is accomplished during 'Bull Sessions' is a lot of . . . well, "Bull" . . . then this is clearly the fault of the leader. It's a leader's duty to limit the scope of topics discussed, to establish an agenda — with specific begin/adjourn times — and stick to it. Limit participants too — not everyone needs to be involved in every topic, what a waste of time and productivity. Demonstrate organization by managing your meetings and your team will demonstrate that organization by managing your company.

What message are you sending? Remember, what is *not* said is often more destructive than what is. Unnatural actions or behavior, such as 'closed door meetings,' will most certainly set off the rumor mill. People need to know or they are left to their own imagination — and that is always worse.

Equally important, level with them — then *get the stay versus go* decision. To address the issues in a forthright manner is no guarantee that you will keep everyone, or that everyone will believe what has been said. But not to communicate what is going on is a lack of leadership; so don't be surprised when employees don't do what you want.

Are goals unclear? Chronic failure to achieve stated business goals suggests a problem far more serious than a lack of performance. Often, it implies a lack of clarity regarding the owner's goals, and usually indicates a failure to secure management team 'buy in'.

Take a long, hard look at the goal setting process. Set goals and hold managers accountable for success.

What is the company's goal? The mission statement should be a directive that states this goal. What usually comes through is "... we are the best at providing a lot to everybody ..." which doesn't say anything. Set a mission statement that tells customers, employees, and stockholders where the company is headed. If it can't be articulated . . . does it really exist? A good mission statement should address six elements, and all six:

- **Service/Product definition** —What do we do or provide?
- **Generic customer need** — Why will they buy?
- **Market definition** — Who will we sell to? Where are they?
- **Technology** — How will we deliver our products and services?
- **Levels of vertical integration** — How much will we do?
- **Distinct competence** — Why will they buy from us?

© Copyright 2010, Strategic Management Partners, Inc.

Most companies are too generic in their definition. Their mission statement is not well thought out. Competition dictates that you focus. Don't underestimate the importance of your key competencies, those strengths that no one else has. Be honest, this doesn't mean just show up at the door. Identify goals that are in sync with these strengths. Do they meet ultimate objectives? If not . . . then why use resources to accomplish them? Remember the ultimate goal . . . companies are in this for the money.

Are compensation and incentive programs yielding unsatisfactory results? While it seems obvious that programs should clearly and directly reward for successful job performance, it's remarkable that many companies unwittingly set up compensation structures that reward performance altogether different from that outlined in the job description; and from what is expected by the board of directors. A word of warning if this is your practice: Be careful what you pay for — you might just get it.

By contrast, managers who are paid incentives based upon gross margin can be more effective than those paid on gross sales. Why? Because they share the burden of poor performance, they're more likely to take corrective action when faced with substandard performers.

Of all the difficult management chores, this isn't one of them. It does assume that you know what you want to accomplish. This requires planning. What is the proper approach? How are people to make it happen? This requires a great deal of thought. Then for the execution: set rewards for performance to attain the plan, pay for performance when achieved, and don't pay for it if not achieved. Set the directive and the goals . . . THEN . . . set the incentive structure.

Specialists are hired for their management ability, the ability to bring order out of chaos, the ability to marshal resources and maximize value from those diverse resources.

Is new business waning? If so, you are out of touch with the marketplace. High prices, unresponsive proposals, and giving more than is required of you are the typical reason companies lose bids.

Commitment to winning new business is essential to success; so identify targets early on — always keeping a close eye on the customer's special needs. Bid to win, and then manage for profit and growth.

Perception is the key; it has many sides . . . to confuse the competition . . . to comfort the customer . . . to fool ourselves. Remember, a dollar must be a dollar of revenue before it can be classified as any other kind. Management must work this area aggressively . . . develop a "We will do what it takes" attitude toward developing new business.

Are any key client relationships deteriorating? Determine if a decrease in business from long time customers is due to poor market conditions in their industry — or poor service from your company. If it's you, you're probably no longer meeting the customer's needs. Worse — you may not know.

Manage customer relationships carefully. Customer needs, like your own, change. Assign specific responsibility for nurturing customer relationships to all levels of management —not just to those within the sales force. By all means, get out and talk with the customer. How else will you really know what the customer thinks? Few customers will call to tell you that they are not going to buy your product any more; they just stop writing checks.

This issue is controversial . . . hard to pin down. Its like venturing into the unknown, and people are uncomfortable doing that. Address the real issue of how customers perceive the company and its product(s) relative to competition. Implement a plan to satisfy customers, so that they will want to purchase. Don't be lulled into a false sense of security . . . those customers may not always be there.

Does the company create 'products in search of markets?' Products developed before market needs are assessed can waste resources and be difficult to sell. It is less expensive to create awareness of a product or service that meets an existing demand, than to develop a new market for existing products or services that doesn't exist.

Identify how your key competencies satisfy customer need and produce benefits. Have your team pretend they are your competition; their task is to identify the strategy that you, the competitor, should pursue. Ask you customers . . . simple but effective.

It is the nature of the engineer to want to create a 'Rembrandt,' something special that meets the needs of all customers. This approach can only add cost to the product, often cost that the customer is not willing to absorb. Keep the 'bells and whistles' to a minimum. If the product(s) is technically oriented, perhaps a modular approach will allow a better fit with various customer profiles, by providing a 'pick and choose' option.

Do financial and management reports cover the wrong information at the wrong level? Financial and operational reports must be accurate, timely, and pertinent. Too often, management receives only traditional accounting measures of company value, instead of cash flow or new business generated. Also, information is often prepared at the wrong level, making it difficult or impossible for management to know what's going on inside their operations.

Cash flow is the best indicator of business health. Prepare forecasts, and then manage to them. Management should determine performance at each level of the business (i.e. profit center, cost center, cash center), and update often.

Does the operation have a track record of failed expansion plans? Setbacks drain businesses of cash, time, and morale. When companies fail in one effort, management tends to 'pull in its horns' the next time out. The result? Suppressed hopes for growth or expansion. Efforts fail because of inadequate cash, poor management, lack of market analysis, or improper control systems.

Managers who run independent operations must be adept at problem solving, decision making, team building, and managerial analysis; skills which are not obvious. Understand why your company is successful in its present marketplace, and try to 'model' those conditions in a new marketplace.

Modeling success can produce growth. The entrepreneur wants it to grow, but *want* alone can only drive the company so far . . . and often into trouble. One is not born to be a manager; you need to cultivate these skills. A Model allows you to depict the new environment without yet being there . . . where mistakes can't impact the real bottom line.

WHAT HAVE WE LEARNED?

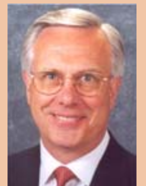
Affecting a turnaround takes an array of skills. When in crisis there is no time for a warm up. To affect rehabilitation, the right leader will know how to make the quick and proper decisions, put a plan into action and keep a talented team moving towards a healthy and more valuable end. Specialists are hired for their management ability, the ability to bring order out of chaos, the ability to marshal resources and maximize value from those diverse resources.

Recognizing trouble requires no hocus-pocus. Likewise, solving trouble's accompanying problems takes no smoke and mirrors. If misery likes company, then trouble loves it; problems can multiply at a frightening speed. Seldom is there only one reason for business troubles; more than likely, you'll discover two or three. The balancing act becomes weighing the risk(s) and taking action versus letting the status quo dictate a troubled course.

One thing's sure: the longer you wait to admit that the company is heading for trouble, the more difficult the resulting problems will be to solve. Getting to the real issues is the catalyst toward change — and recovery.

And that's a much more acceptable risk.

John M. Collard
is a Certified Turnaround Professional and chairman of Annapolis, Maryland-based Strategic Management Partners. He is also past chairman of the Turnaround Management Association, and an advisor to private equity firms.
Strategist@aol.com www.strategist.ws (410) 263-9100



A Hands On Approach

Executing a turnaround is no easy task. John Collard, of Strategic Management Partners, spells out the guidelines to get an under-performing company up to speed

By John M. Collard

The Dealmaker's Journal

Investing in under-performers has become a more acceptable practice, as it can be very profitable if investors know what to look for and how to execute, as many buyout firms and hedge funds are finding out. Success, however, depends largely on the ability to determine if a troubled company is in fact turnable and if so, how to fix the problems. The key, investors are finding out, is to not spend money on past sins and to obtain at the right price, which on top of implementing a turnaround, can result in a rewarding process.

This niche market allows investors to capitalize on initial positive results, which have become stalled investments. It's important to seek out enterprises with a critical capital shortage, but still show future potential. Investors should look for companies that can provide quality products at competitive prices that are severely undervalued due to ineffective management, and/or lack of market direction and unacceptable penetration. There are opportunities that require capital, yet may lack competitive market experience and essential managerial skills. But the infusion of capital put into the hands of a leader with a sound strategy and a return-on-equity goal in mind can be a powerful motivator.

The key to returns from investing in under-performers is to build properties that future buyers want to invest in. Investors need to build an enterprise with the sole purpose of selling it at maximum value, which means concentrating on exit strategies from the start. To do this, it's important to keep in mind what future buyers will look for: namely consistency; a high probability of future cash flows; a marketing-oriented management team; and a realistic potential for a buyer's return from their entry valuation.

There is great value in rebuilding an entity and setting it on a path toward long-term growth — at which point it becomes time to find an exit. There are many buyers who accept lower return rates for stable growth and shy away from under-performers until they have been fixed, so it's important to leave some future enticement for the new buyers.

Recovery Cycle

Whether the investment is in a new entity or a portfolio property gone bad, the recovery cycle is much the same. Most troubled entities reach that state through a progression of mismanagement — from officers to board members to investors. When the entity is at a precipice there is opportunity. The present owners, lenders, and other stakeholders will have little choice but to bargain, and deals can be made. Be cautious however, because many wait too long and while doing so, allow the value to deteriorate completely. Avoid the pitfall of investing in an insolvent company with no fix available; as surprising as this sounds, many do.

Determine viability by understanding what is wrong within the company (usually two or three things) that has caused their breakdown. Don't be fooled by symptoms, and never listen to current management; if they knew what was wrong they should have had a prior fix.

A crucial element is to provide solutions to fix the real problems that no one else has used, whether it's new non-cash resources or applications to influence the revitalization. Investors should take advantage of mispriced material inputs, labor, assets or capacity, and intellectual property. The answer is never, "just add cash," and always requires new leadership to implement change.

Negotiate acceptable terms that allow for substantial upside when the work is done. If there are no solutions, creditors won't cooperate, or if the price is unrealistic, go on to the next deal. Finding good turnable deals is fundamental to success.

Take Control

There must be a successful turn before the entity can be sold. Never leave this to chance and always take active control of the entity. Passive investing if managed by prior management is like a placebo, and often leads to a lost investment. Passive positions are only acceptable if they contribute to an investor pool that has an active lead participation.

Many equity investors approach an under-performer scenario in their own portfolio by applying strictly financial considerations. These same [financial] investors compound their problems when they take control of their company to determine whether or not it can be salvaged or lobby for sale or liquidation. When sold, which is often the case, they write-off their investment. Inherent in this scenario is a fundamental problem; purely financial consideration is not enough when an operational or revenue-driven turnaround is required. While many investors have run financial or investing institutions, few have run companies as well, and are ill equipped to do so. This, however, leads to opportunity for those who can run companies.

There is substantial value derived from investors who also have senior operating leadership experience in their background. They can determine whether one strategy or another can affect the revitalization, and why others didn't work in the past. Many private equity firms and hedge funds are adding operating executive talent to compliment their managing partners.

Some may recognize the often used axiom: "Lead, follow, or get out of the way." When there is an underperforming entity, it is time for existing management to 'get out of the way.' They guided the company during this mismanagement slide, so why allow them to complicate the

situation any further?

Process of Recovery

There is a process to guide an entity through corporate renewal. It involves utilizing a transferable set of skills to revitalize the property and restore it to a sale-worthy state.

To do that, investors want to focus on value creation and guide the company to a new plateau. Their advantage is that of an objective focus, untarnished by the situation at hand. They can bring a perspective that does not reside within the company because the players lack experience with their new situation. These investors should be the teacher, while the stakeholders are the pupils, and together the company should be rebuilt to move in new direction. Successful investors effectively manage "change control."

To move in this direction, investors should install a CEO with transition experience in value-building situations. This leader will demonstrate expertise in: managing crisis, transition, and rebuilding processes; shaping business strategy and financial structure; developing management talent and utilizing and growing existing resources; growing sales and market share; maximizing return on capital; and developing incentive-based compensation programs.

This leader must get directly involved in making decisions to achieve the ultimate goal — a sale at increased valuation. He or she must be held accountable for performance and timely results. Most importantly, they must get things moving. On the "volume in" (revenue/sales) side, look at where and how revenue is generated, and keep it coming in. On the "volume out" (throughput/production) side, ensure that the product or service gets 'out the door'.

The final step to complete the turn is to hire a 'marquis' manager to lead the enduring team. This permanent team adds to value equation.

Set Strategy

The investing goal is a shorter-term high-multiple return (for the risk) while allowing the ongoing longer-term returns for the buyers who provide an exit. It is crucial to implement long-term strategies that will survive your exit.

While situations differ, one essential strategy is to drive revenues; growth cannot occur without more sales. The strategy must address the problems plaguing the company, and provide a roadmap to revitalization. If the only solution is to pursue strategies tried before, then don't invest.

An effective strategy is key to implementing change. Investors must establish a new vision, distill this direction into concrete goals and objectives, and create a guide for everyone to follow. Rebuilding momentum is critical to success.

Also, the value of a company increases sharply with a strong permanent and credible team, who can demonstrate their ability to produce consistent sales, profit and cash flow results. Establish continuity in the organization to allow everyone to expect orderly change and opportunity.

Capitalize on available under-utilized human capital — essentially the middle managers that remain. Chances are that they are dedicated to the company and its success. Guide them to their next level, and they will take the company the next big step.

Of course, another consideration, and of key importance, is to acquire new business and improve sales. There are only two ways to increase sales: Either sell new products to existing customers, or sell existing products to new customers. Most under-performers have forgotten, or never had, the basics of marketing and promotion. Clearly promote what your products and services can do for your customer to satisfy their needs and differentiate why the company's product stands apart from the competition.

Become market driven, adapt to changing conditions, and improve your competitive position. Deliver only what customers are willing to pay for and no excess (more cost).

Meanwhile, a major component to success is to create reasons for investors to invest. A sound strategy with a viable marketplace, efficient delivery and production vehicles coupled with a cohesive management team will entice the investment community. Securing new capital becomes much easier when investors see high probability of return and a viable exit strategy.

As important to infusing cash for working capital needs is to make certain that cash won't be diverted to past commitments. Establish relationships with creditors so they will work with the new management team — give them upside when the turn is complete. Consider a 'Creditor's Committee' approach (out of bankruptcy) to keep them plugged in and participating. Pre-packaged bankruptcies are also available to ensure cooperation. Investors can always purchase assets out of bankruptcy to ensure a clean structure, a strategy being utilized more often as buyout funds get more comfortable with the process. In many ways this approach can be considered alternative and complimentary financing.

Investors taking a turnaround approach should implement systems and processes to drive the business and control the day-to-day environment, which allows management to run the critical elements of the company. Many managers waste time on tasks in which the results would be essentially the same whether they managed them or not. Focus on the important things — controlling cash and costs, increasing sales, enhancing value creation, and manage these.

"As important to cash infusion for working capital needs is to make certain that cash won't be diverted to past commitments."

Processes define guidelines and expectations. Watch for the benefits derived from communicating what is expected. This will re-establish delegation of authority and expectation to those who can turn the events of the company, and more importantly, demonstrates the value of this recurring phenomenon. When results are recurring this stimulates value.

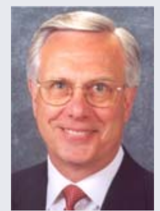
Lastly investors should leverage all resources (People/Facilities/Advisors) to complete the turn. Often the key resource is the employee. Set up an incentive structure that pays only when they accomplish the goals set in your long-term strategy. A robust incentive structure shares the risk and if successful then everyone will gain. If not, though, then it isn't profitable to subsidize poor performance. The incentive for investing is the return when the sale occurs. The employees' incentive should be based upon performance that will take the company beyond its sale. After all, they are a key asset that a potential buyer is looking for.

To maximize the return, it is essential that investors know when to 'cash-out'. The greatest ROI comes when the turn is complete and the company is ready for the next tranche to fund growth. At this point there are many new investors who will want to participate.

In summary, investors need to leverage opportunities to take advantage of distressed level asset pricing in distressed situations, when the risk-to-reward ratio is high. They need to take operating control in all entities to make certain that those decisions that few understand are made to influence the outcome and install leadership with extensive experience and past success revitalizing and restructuring entities.

Buy, invest, manage and renew with one thing in mind: Maximize value for Resale.

When the process is completed, only one result can occur — value



John M. Collard, is Chairman of Annapolis, MD-based Strategic Management Partners, Inc., a nationally recognized turnaround management firm specializing in interim executive leadership, asset recovery, corporate renewal governance, and investing in underperforming companies. He is Past Chairman of Turnaround Management Association, a Certified Turnaround Professional, and brings 35 years operating C-Level leadership, $85 million asset recovery, 40-plus transactions worth $780 million, and $80 million fund management expertise to advise company boards, litigators, institutional and private equity investors. He can be reached at (410) 263-9100. Or, for more information, visit www.StrategicMgtPartners.com

Reprinted with the permission of Mergers & Acquisitions, The Dealmaker's Journal, and SourceMedia, Inc. © Copyright 2007

© Copyright 2010, Strategic Management Partners, Inc.

DOWJONES
Daily Bankruptcy Review
Covering Key Issues and Events In Distressed Situations July 6, 2005

VIEW POINT

Looking For The Exit: An Approach To Investing In Underperforming Companies

By John M. Collard, CTP

John M. Collard

Professionals guiding investors or looking to invest in underperforming companies themselves should be aware of what to look for and how to execute. The key to returns from investing in underperformers is building an enterprise with the sole purpose of selling it at maximum value - to concentrate on exit strategies from the start.

First, seek enterprises at a precipice, not those that have already fallen off the edge. Look for those with critical capital shortages and future potential, but avoid the pitfall of investing in an insolvent company. Acquire companies that can provide quality products at competitive prices but are severely undervalued due to ineffective management and/or lack of market direction and penetration.

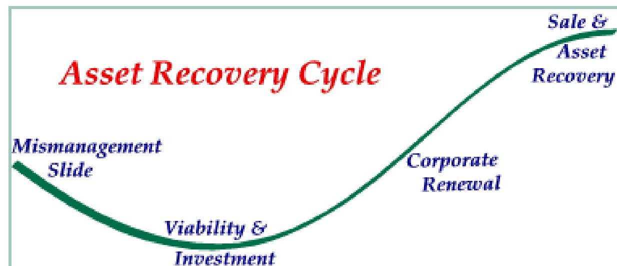
Take advantage of distressed-level asset pricing and invest in exchange for large returns. The infusion of capital put into the hands of a leader with a sound strategy and return-on-equity goal in mind can be a powerful motivator.

Provide what future buyers look for:

- Consistency of businesses that create value
- High probability of future cash flows
- Marketing-oriented management team
- Track record demonstrating ability to sell and compete, develop, produce and distribute products, thrive and grow
- Realistic return potential from their fair entry valuation

Recovery cycle

Whether you invest in a new entity or a portfolio property gone bad, the recovery cycle is much the same. This cycle starts with mismanagement. Then you need to determine the viability, invest, turn and ultimately sell the property.



Determine turnaround viability by truly understanding what has caused the company's breakdown. Don't be fooled by symptoms, and never listen to current senior management. If they knew what was wrong, they would have fixed the problems.

Make certain that you have solutions to fix the real problems that no one else has used, perhaps because you can bring in new noncash resources or applications to influence the revitalization. Take advantage of mispriced material inputs, labor, assets or capacity, and intellectual property. Never "just add cash," and always implement new leadership.

One of a series of opinion columns by bankruptcy industry participants.

DOWJONES
Copyright 2005 © Dow Jones & Company, Inc. All Rights Reserved.
Http://www.djnewsletters.com

VIEWPOINT

Take control

There must be a successful turn before the entity can be sold. Always take active control of the entity. Passive investing if managed by prior management is like a placebo, and you will lose your investment. Passive positions are only acceptable if they contribute to an investor pool that has an active lead participation. Install a new chief executive with transition experience in value-building situations. The executive should bring an objective focus and new perspective to complete the cycle. This leader should demonstrate expertise in:

- Managing crisis, transition and rebuilding processes
- Shaping business strategy and financial structure
- Developing management talent, building caliber teams, utilizing and boosting existing resources
- Increasing sales and market share
- Maximizing return on capital
- Linking management performance to ultimate goals
- Developing incentive-based compensation programs

This leader must get directly involved in making decisions to achieve the ultimate goal - sale at increased valuation. The final step to complete the turn is to hire a "marquis" manager to lead the enduring team. This permanent team adds to the value equation.

Set strategies. Implement long-term strategies that will survive your exit. One essential strategy is to drive revenue by addressing the problems plaguing the company and provide a roadmap to revitalization. You must establish a new vision, distill this direction into concrete goals and objectives, and create a guide for everyone to follow.

Build a quality management team. The company value increases sharply with a strong, permanent, credible team that can demonstrate its ability to produce consistent sales, profit and cash flow results. Establish continuity in the organization to allow everyone to expect orderly change and opportunity. Capitalize on available underutilized human capital - those dedicated middle managers who remain. Set up an incentive structure that pays only when they accomplish the goals set in your long-term strategy. Their incentive should be based upon performance that will take the company beyond its sale. After all, the employees are the assets for which your buyer is looking.

Acquire new business/sales. There are only two ways to increase sales, sell new products to existing customers or sell existing products to new customers. Most underperformers have forgotten, or never had, the basics of marketing and promotion. Become market driven, adapt to changing conditions and improve your competitive position.

Establish a sound capital structure. Create reasons for investors to invest. A sound strategy with a viable marketplace, efficient delivery and production vehicles coupled with a cohesive management team will entice the investment community. Securing new capital becomes much easier when investors see high probability of return and a viable exit strategy.

Implement processes. Use processes to drive the business and control the day-to-day environment. Focus on the important things - controlling cash and costs, increasing sales and enhancing value creation.

Exit

Know when to "cash out." The greatest return on investment comes when the turn is complete and the company is ready for the next tranche to fund growth.

Remember that there's a distinct advantage to using professionals who bring C-level operational, transactional and turnaround expertise together to determine what's wrong, how to fix it and how much to pay for it.

(Opinions expressed are those of the author, not of Dow Jones Newsletters.)

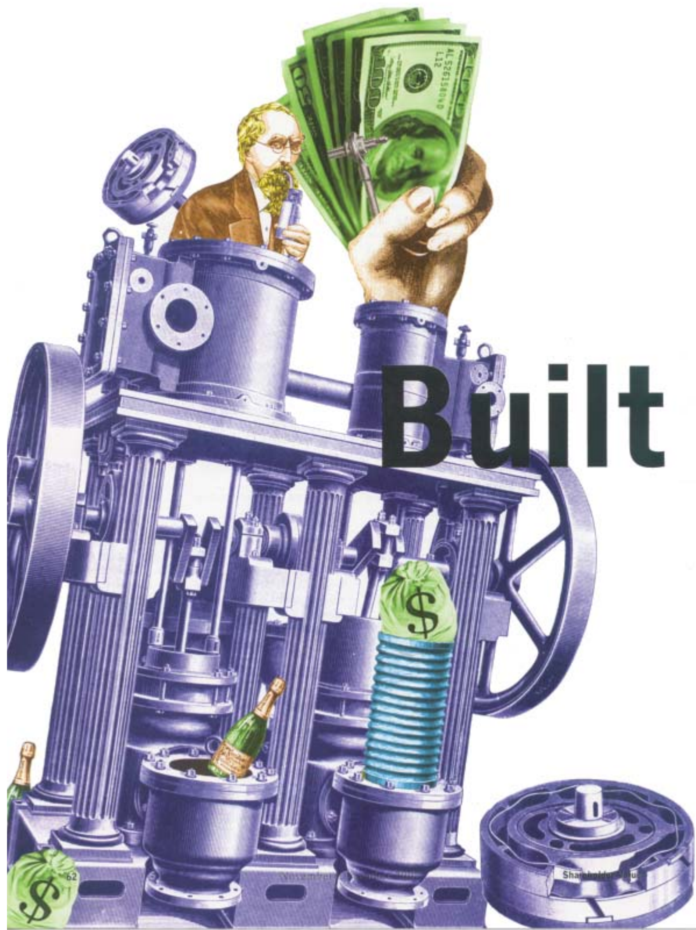
John M. Collard is a Certified Turnaround Professional and a past chairman of the Turnaround Management Association. He is chairman of Annapolis, Md.-based Strategic Management Partners Inc. (www.strategist.ws) a turnaround management firm specializing in interim executive leadership and investing private equity in underperforming companies. He can be reached at (410) 263-9100 or Strategist@aol.com

DOWJONES

Copyright 2005 © Dow Jones & Company, Inc. All Rights Reserved.
Http://www.djnewsletters.com

"The odds of a successful turnaround increase dramatically if a turnaround phases-and-actions plan is implemented and followed."

- John M. Collard



Value Creation Model

By John M. Collard

Shareholder Value Magazine
December 2002

Here's a primer on how to build a value creation model aimed at achieving the kind of steady growth that attracts investors and future buyers of a business itself. The key business attributes and how to create the most value in them are spelled out. While focused on private companies, the learning offered here can apply to any business.

Valuing a company is the easy part; creating that value in the first place so you can measure it is a more formidable task. Create a Value Equation to build Worth into your company.

Determining value is more art form than science. True value can only be established at the time of transaction, where willing buyer tenders payment and willing seller accepts it in exchange.

Buyers and sellers look at component make-up of a company differently, and therefore, place different values on these ingredients and on the whole. To enhance the real company value, analyze company components as they relate to worth in the mind of potential buyers. Value to one buyer often does not necessarily hold the same value for another. Establish multiple buyer profiles depending upon the circumstances and prepare to build value each would be willing to pay for.

There are essentially two kinds of buyers — Strategic and Annuity Buyers, both with different motives. Yet, both demand returns for their shareholders.

The Strategic Buyer purchases for reasons that fit into their strategic plan. They benefit through synergy like acquiring customer base in expanded territories, new products, added capacity, and reduced costs, et cetera. This type buyer may place some value in the first line management team, but will see added value in the ability to place their own managers into key positions.

The Annuity or Financial Buyer, on the other hand, sees value in the stand-alone entity's ability to generate cash flow from profits year after year. The institutional buyer places the highest value on how motivated and incentivized the existing management team is, and their receptiveness to remain to generate cash and profits. The owner/operator conversely will look at 'buying a job'.

Typically, strategic buyers of closely held companies purchase at six to 10 times earnings and/or cash flow, while annuity buyers pay two to six times cash flow. The ultimate worth of the company depends upon who the buyer will be. These multiples are usually considerably higher in public companies, but the concepts of building value are the same.

The essential, is to look at what is valuable and understand how to exploit and preserve this value. From the start, plan to sell the business and put value creation into perspective.

Free cash flow and the continued ability to produce it with reliable probability creates the greatest value. This is not as easy as it sounds. In fact, it can be complicated, is often misunderstood, and frequently is bungled. Look at the elements in the Value Creation Equation to see how each brings forth value and how together they compound the effect.

Value Creation = Net Asset Value +
Future Revenue Stream + Going Concern Value
+ Incentive to Purchase

Net Asset Value (NAV)

Sometimes referred to as Orderly Liquidation Value, it is the cash net worth of assets less encumbrances if you were to liquidate these assets at a fair market price under orderly disposition conditions when liquidation is not necessary. This NAV can equal Net Worth on the Balance Sheet, but is often adjusted for the value of intangibles.

Simply stated: Tangible Unencumbered Book Value + Intangible Assets + Adjustments to Market Value (Over-amortized/depreciated/expensed assets, or Inventory written lower than market value) - Obsolete Inventory and Bad Debts - Outstanding Obligations on open contracts = market value. Build a strong, balance sheet with adequate reserves and proper statement of asset value, because this is a fundamental on which to expand a company and increase its worth.

About the Author

John M. Collard is Chairman of Annapolis, MD-based Strategic Management Partners, Inc., a nationally recognized turnaround management firm specializing in interim executive leadership, corporate renewal, and post-acquisition support for the private equity community. He is Past Chairman of the Turnaround Management Association; serves on public & private boards of directors; and is an author, speaker, advisor to companies, institutional and private equity investors, and governments. (410) 263-9100 www.strategist.ws

Tangible assets can be appraised to establish their worth. On the other hand, intangible assets are harder to value because they are subject to interpretation. If you sell a machine you realize cash for the transaction; but if you lose a customer, no one pays you for it, they're just gone. Intellectual property is also hard to value, but filing more patents will generate value, particularly to those who can afford to protect them from infringement.

The real opportunity lies not in building asset base, but in building maximum return on those assets and deployed capital. Assets don't generate worth by themselves, they can only be used to generate worth. If the asset sits idle, it is actually losing value, but if volume causes the asset to work to produce output production, value is being created.

The closer the relationship of assets to realize $1 for each $1 dollar on the balance sheet the better. Cash and Securities fit this description. Accounts Receivable will be discounted as they age; focus on keeping the days outstanding as low as possible. Utilize percentage completion contracts when possible to keep receivables low and cash flowing.

Utilize just-in-time and consignment agreements to keep raw materials at the lowest levels possible to minimize obsolescence. Produce in-process work expediently to cover short-term needs. Build finished goods for firm orders or reasonable short-term expectations of sale, don't overproduce. If in a seasonable business cover production levels over the off-season with contracts for sale of goods just before the season, cover the risk with orders for goods. It may be better to have less than market demand if projections were off, compared to interest and carrying costs to hold artificial Christmas trees until next year.

Customer Lists, contacts, name recognition, trademarks, reputation, Web distribution channels and Internet presence are often not considered in asset valuation because they are not carried on the balance sheet. These assets, however, are often worth considerable value in the market place. The reasoning for this theory is that these assets can be turned into cash; therefore, should equal the related value they could generate in return for their sale. These intangible assets can produce future sales, profits, and cash.

Future Revenue Stream

A real value in any company starts with its revenue stream; the more you can count on it occurring, the more value it has. The value becomes the net present value of the after tax free cash flow stream of revenue under contract, plus repeat customer base. Contract backlog is worth much more than revenue that you must locate every year. The cost to re-create the sale each year is high in terms of time and human energy. Locate customers where multiple year contract environments can be set up. The government often awards contracts for multiple year periods. Many larger companies favor contract relationships with vendors to reduce the overall cost of screening vendors again and again.

While not as quantifiable as backlog, there is value in a customer base that's been maintained for a long period of time. The longer customers remain with a company, the more likely they will be loyal in the future. When customers stay with an organization, this is an indication of the value, which they receive from that organization. Conversely, customer turnover indicates their dissatisfaction in the company's ability to provide services. For example, software companies retain customers and repeat sales with product upgrades and gain new customers with import utilities for easy conversion.

Clearly growth in revenue volume is an indicator of valuation in a company that investors are willing to pay for. If customers flock at above industry levels to a company for the services that they provide, this is a good indication of the company's ability to perform at above expected levels. A motivated sales force with the ability to generate new revenues year after year has more value than a company who has a poor selling reputation. A lack of growth indicates that the company does not have an ability to increase its value over time.

When a company has a great, and believable, prospectus for the future, the buyer will often plan additional capital investment to fuel growth. If this case, the buyer could be motivated to pay a higher valuation for the company and then invest on top of it.

Going Concern Value (GCV)

Here is where the fun begins in all transactions. The going concern value and goodwill, or soft assets, will always draw the most controversy and discussion in terms of their valuation. These elements are most prone to differing interpretation by buyer and seller.

Here to is where you can build the most value into a company. Transaction value is only at a point in time. Buyers and investors look more to the company's ability to create additional value to enhance returns on invested capital as they hold their investment. Impart the elements that Future Buyers look for:

Businesses that create value. Consistency is the key. You must demonstrate growth in revenue, profit, and cash flow. Do everything in your power to eliminate and manage 'hick-ups' along the way. Audited statements go a long way toward verifying results, in spite of some recent press.

High probability of future cash flows. A history of positive cash flow at increasing levels is important. True annuity buyers purchase cash flow not the business. Strategic buyers will value cash flow plus what will happen if additional capital is provided. After all, free cash flow determines the periodic return on investment and increases the potential for much higher purchase price in the future.

Management team and human capital. Attract and motivate a marketing oriented management team with the ability to produce recurring profits, return on capital, and free cash flow as an annuity for the owners. Develop an in-place; stable, well-trained workforce to implement operating processes on an ongoing basis. This is the most valuable off-balance sheet asset. When the owner of a privately held business has transitioned out and is collecting net profit and cash without participating in an active management role, the value increases dramatically.

The ability to sell, compete, distribute, produce, develop products and thrive. This stand-alone entity track record demonstrates the viability of the market relationship between the products/services offered to meet customer demand and need, ability of the company to compete, and company reputation in the marketplace. The more unique a product is the more value it contributes to the deal. The company must be able to differentiate its products and services from the competition, even if this is based mainly on perception. Remember, products do have a life cycle and require improvements to remain in demand.

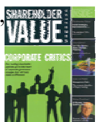
The directors' and management's role must be to build Going Concern Value! The GCV can be best maximized with stable leadership, setting and following sound strategies to consistently bring products and services to market, all the while nurturing resources and implementing processes to manage the company. Here is where the greatest value resides.

Incentive to Purchase

Create reasons for a buyer to want to consider your company as an acquisition candidate. Buyers want a Fair Entry Valuation so that they can expect a realistic return potential. There must be Exit Options so that the buyer who buys your business can realize high ROI at the time they resell.

The better the company is at creating stakeholder value and shareholder return, the more interest there will be in buying some or all of the stock. While investors often buy on hope and promise, the dot com market sector collapse clearly indicates a need to ultimately produce returns to substantiate investment. Think for a moment, had many of the dot com managers built GCV to support their promising technologies, they might still be around today. Those that have built GCV have strong balance sheets, can weather the storm, and will undoubtedly find opportunities to gobble up assets from those who didn't.

Build on any one element in the Equation and you increase its individual value. Build up all elements in the Equation and you realize exponential creation of value to the right buyer. The buyer looking for a standalone entity to produce an annuity stream will place the highest value on a company when all components are strong and it operates with little owner intervention. Buyers looking for parts of a business to augment their own, will want to invest less and only place value on some components, regardless of how strong they are. For example, if you build a strong senior management team, but a buyer wants to run the business, they will place no value in your senior managers that will be replaced.



Remember, as in *Field of Dreams:* "If you build it, they will come."

DIRECTOR'S Monthly

The official newsletter of the
NATIONAL ASSOCIATION OF
CORPORATE DIRECTORS

VOL. 18, NO. 8

AUGUST 1994

STRATEGY BRIEFS

A Director's Guide to Defense Conversion: How to Avoid Minefields in the Marketplace

John M. Collard, President
Strategic Management Partners, Inc.
Annapolis, Maryland

Defense manufacturers that head blindly into uncharted territories are asking for peril.

The nation's shift to a peace-time economy is forcing many companies into a real battle for increased sales. Their defense conversion efforts may be a matter of new products, new markets, or both.

Some companies are finding new, peaceable applications for their military technology. Others remain committed to their product core. But all defense companies are in search of new markets.

Corporate directors are expected to participate in the strategic planning process. If you are a director of a company seeking to find new markets for defense products, you are not only expected to participate in the planning process; you may be needed to lead it.

Even if companies you serve have not been affected by the defense conversion yet, they will be. Your first reaction to the increased competition may be to advise management to look for new markets. But new markets bring new rules and new ways of doing business, so look before you leap.

New Products

Determine if your company has products and skills that are transferable to new markets. This can be a challenge. Where can you sell a long-range bomber or a guided missile system? To a foreign power? Since foreign military sales are governed by the Pentagon, you probably don't have many choices.

But the technology that was used to develop a given product may have specific applicability in other arenas. The company you serve may have to change the look and feel of what it is offering, depending upon what a new customer needs. San Diego's XXsys Technologies, Inc., is taking the ultrastrong materials it used in B-2 bombers and is now putting them into bridges and roadways.

To move into a new market segment requires a different way of doing business— a fundamental change in approach.

New Markets

The end of the cold war pulled regional economies from their roots and shook off what had been rich soil for easy growth. During the '80s, defense contractors flourished with or without sound strategic planning skills. The government mandate to cut defense spending has forced many contractors to develop such skills — A.S.A.P.

One-time missile manufacturers and former F-14 fabricators are looking for new markets and forcing sales-starved chief executives into new territories without the proficiency to generate revenue once they get there.

Even larger companies have been hit hard. Connecticut's Pratt & Whitney division of United Technologies used to sell some 700 military jet engines a year. This year, orders have dropped to around 50 engines.

(continued)

© Copyright 2010, Strategic Management Partners, Inc.

Strategies for Winning Business in New Markets

	Government	Commercial	Global
Contract Environment	Life-cycle award: structured by FAR	Not structured UCC governs	Rules of country: $ exchange rates
Market Environment	Limited; highest-value wins	Caveat emptor; business abounds	Wide open; who you know/pay
Distribution/ Differentiators	Procurement process; design to spec	Salespeople; alliances	Connections; local presence
Technology Importance	Very important; military-oriented	Solution focus; relationship-driven	Paramount; transferable
To Win:	Give fair value for $	Demonstrate benefit	Boost local economy

Any significant drop in sales usually leads to a shake-up in employment. For example, in Maryland, Westinghouse Corp.'s electronics division has reduced its work force by 40 percent in the past five years. In the height of the defense build up, Westinghouse employed more than 17,000 people in the region. Today, it employs less than 10,000 there.

These companies have been able to diversify their commercial base, but most businesses don't have a back-up plan just in case their major customer walks away. Instead, Plan B often becomes a bootstrap effort to reach out to the "hot market of the month," typically a segment that has been tapped out even as it soars in popularity.

To move into a new market segment requires a different way of doing business — a fundamental change in approach. While a company may be capable of making the shift from government contractor to commercial supplier, and from commercial supplier to international manufacturer, its leaders will need to understand that customer motivation and timing differ in each marketplace.

Most boards will look to the wide-ranging and economically unrestrained commercial marketplace for renew opportunities. But pitfalls await anxious CEO's and directors here, as well.

Typically, you will find management steering a company into one of three major market categories. As you advise and assess strategy, here are points to keep in mind. Here's a look at each major market segment:

Federal buyers are looking for commodity-based solutions. They are looking for value — the best products at the best prices. If your company's marketing efforts are geared toward building relationships first, your competition will be out the door with the contract while your account managers are still warming up to the procurement officer. In this market, management will have to price low to win bids now, then work to cut costs or negotiate adjustments later.

On the other hand, commercial buyers look for cost-effective (typically fixed-price) solutions that operate within the complement of existing investments.

In the international market, price and product are important, but the bottom line is who you know—not just what you are selling.

Government Contracting

Two different markets are open for opportunity within the government contracting sector: "set-asides" for qualified sellers (typically small ones), versus competitive procurement opportunities for all sellers (typically large ones).

Government set-asides are programs targeted to small, and/or minority disadvantaged businesses. There are many such qualified sellers so the key here is to get there first.

If management is targeting the government set-aside market, it will find a constantly churning market of entering and exiting players, all of which are vying for contracts in the $10,000 to $10 million range. What you do is more important in this market than how you do it.

Larger federal procurement contracts are obtained through a lengthy and very competitive bid process. Competition is intense, and scattered among the major aerospace and weapons companies, major suppliers, and established systems integrators. Additionally, there is a second tier of competition brought on by subcontractors who are bundling services to win contracts and become part of larger teams.

Reputation is important when it comes to securing these federal contracts. So is top-to-bottom company support. Competitive bids require a significant corporate commitment just to win the contract.

The low bidder is always the winner in the competitive government contracts market. But the low bidder may not always have the lowest price.

Today, contracts are going to the "lowest evaluated bidder," or the bidder who brings the most value for the price to the table. Lowest-evaluated bidders have been beating out the lowest-priced bidders for

© Copyright 2010, Strategic Management Partners, Inc.

some time now and are proving to be stiffer competitors. Plan for long lead times, mountains of paperwork, and rock-bottom pricing in the somewhat flat new acquisitions market. Businesses go fishing for deals anywhere from $5 million to $100-plus million to $1 billion in this market segment.

Commercial Market—Domestic

Most boards will look to the wide-ranging and economically unrestrained commercial marketplace for new opportunities. But pitfalls await anxious CEO's and directors here, as well. With so many potential sellers, this is truly a "buyers market," subject to buyers' whims. Management's industry knowledge is paramount here: the company's products and services must be easily defined and understood.

This market is responsive to relationships, increasing prospects and future stability for service-oriented companies. On the other hand, in this market, unlike the government contracting market,

Three Case Summaries

	A $25M NASDAQ Manufacturer	A $33M Weapon Systems Contractor	A $59M Systems Integrator
Who:	A $25M public NASDAQ traded micro-processor based manufacturer defense contractor, provider to US Gov't, NATO countries and contractors; with 240 US employees and 60 European employees.	A $33M weapons systems development and deployment engineering services to U.S. government contractor providing, especially the air/space segments of the military, SDIO, NASA, and National Laboratories. With 300 employees.	A $59M systems integration, facility management, networking and engineering U.S. government contractor in the 8a disadvantaged business set-aside program, servicing federal government agencies. With 660 employees.
Situation:	No sales force. Too many accountants and engineers. Losing money. Market shrinking with defense cutbacks. Bank called the credit line and imposed daily covenant certification. Trade creditors filing suits. Desperate for new capital and leadership. The classic turnaround situation.	No business development function or staff; had not won a major contract in 3 years. Market shrinking with defense cutbacks. Market direction uncertain. B&P funds deteriorating; profit margins eroding. High overhead rates. Prices not competitive. Backlog eroding. Desperate for cash.	Owner was part of everything, wouldn't delegate. 42 percent employee turnover. Business development and program management didn't work together. Had not won a major set-aside contract in 4 years. Never won competitively, at maximum size for 8a contractor. Bank called out of covenant loan. Losing money; no cash. Planned to become $200M commercial systems integrator in five years.
Strategic Recommendations:	Identify crucial issues and isolate specific causes. Develop realistic long term plan for transition from "product to market" to "integration services" orientation, and a short term option to cut losses if the conditions prohibited a successful turnaround.	Develop a plan to increase sales win ratios. Shift out of defense into environmental air quality improvement to reposition the company to achieve greater value for the owner. Develop creative pricing structure and strategy review process.	Implement plan to graduate from 8a program. Build management team to operate in new competitive commercial and international marketplace. Increase sales win rates, and reposition company in new areas to get greater value for the owners.
Results:	Successful turnaround of public company. Return of value to investors. The company was recently sold.	New business at historic sales win rates, and expanded operations in new markets.	Winning competitive bids. Following realistic growth expectation of $120M in 5 years with 40 percent to come from commercial market.

© Copyright 2010, Strategic Management Partners, Inc.

buyers can be fickle. You may be providing exactly what a buyer needs, but that buyer may suddenly decide he or she doesn't like your wrist-watch. And if your competitors have similar, yet inferior products, they may still be gaining an advantage if they have invited the buyer out on the golf course three out of the past four weekends.

Good relationships - from service to smiles - mean everything in this market.

Commercial Market — Interntional

As more businesses wander outside the borders of their native countries, the international market will become increasingly more competitive. Yet companies seeking to move from U.S. government buyers to commercial buyers in other countries won't find it any easier to navigate until others make inroads. For better or worse, the inroads — and the competition — are there. Japan and countries in Europe have been doing defense business internationally for years. U.S. defense businesses are relative newcomers to the international markets, but they are not the only new kids on the block. There's increasing competition from Latin American and Eastern-bloc nations with low labor costs.

Good relationships — from service to smiles — mean everything in [the commercial] market.

If relationships are "key" in the commercial market, in the international market they are "king" — sometimes literally. In the international market, in fact, some relationships can be traced by bloodlines.

Whereas the U.S. welcomes foreign products, many countries limit imports. Both Ford and Honda have proven this point with their widely scattered worldwide plants.

Exclusionary tactics often range from burdensome import duties and competition-limiting treaties to competing against local government subsidized bids. And don't be surprised to hear that the company you serve is paying "entry" fees all the way through a power structure that includes distributors who may well be the King's (or President's or Commander-inChief's) nephews. As a director, you will want to be well-versed in the Foreign Corrupt Practices Act, including 1988 amendments, in monitoring these payments.

Foreign buyers are commercial in nature, yet they favor their own suppliers unless what they need can only be purchased abroad. And they may only be outside their own borders for a short time seeking technology transfers, as many technologies are replicable.

Parting Advice

Here are some summary tips to keep in mind as you serve on the board of a defense manufacturer. Make sure management:

- knows the company's competitive strength's and weaknesses — how do the company's products and services compare to the competition in terms of technology, design, and cost?
- respects the limits of the company's resources — it should build only one or two market niches at a time, not try to conquer the world.
- protects the market share it has already earned while it reaches out for new business. Markets neglected while reaching toward new sales become prime targets for the competition.

Finally, as a director, be willing to throw all assumptions out a window. New markets bring new personalities, customs, and business traditions to the table. Use your experience to help managers adapt.

__John M. Collard__ is president and founder of Strategic Management Partners, Inc., an Annapolis, Maryland-based transition and turnaround management firm that specializes in valuation enhancement, corporate renewal, defense conversion and strategic repositioning.

Formerly Collard served as president of __Delta Data Systems__, a $25 million manufacturer in a turnaround. He also was a vice president with __Martin Marietta__, where he was responsible for turning or transitioning troubled segments.

He serves on the board of directors of both public and privately held companies and is a frequent author and speaker. He is one of only 24 industry professionals who have earned the Certified Turnaround Professional (CTP) designation. In addition, Collard is currently chairman of the __Turnaround Management Association__. His company was named as one of the "Twelve Outstanding Turnaround Firms of 1993" by Turnaround and Workouts, *a newsletter based in Washington, D. C.*

Director's Monthly is published by the National Association of Corporate Directors and each monthly edition is received by over 8,000 directors of public and privately held companies. Founded in 1977, the role of this association is to enhance the governance and performance of business entities.

DIRECTOR'S Monthly

The official newsletter of the
NATIONAL ASSOCIATION OF
CORPORATE DIRECTORS
1707 L STREET, NW
SUITE 560
WASHINGTON, D.C. 20036
(202) 775-0509
www.nacdonline.org

VOL. 23, NO. 4 | LEADERSHIP AND CHANGE | APRIL 1999

IN THIS ISSUE

Features

- TURNAROUNDS
  John M. Collard
- CROSS-CURRENTS OF CHANGE: A LEADERSHIP DIALOGUE
- PRIVATE COMPANY BOARDS
- BOARD RECRUITMENT: TIME FOR A NEW APPROACH

TURNAROUNDS

All Leaders Are Not Created Equal: To Save the Company — Change the Leadership Style

John M. Collard, Chairman
Strategic Management Partners, Inc.
Annapolis, Maryland

In time of crisis and transition, who can handle the crisis management role? This is a predicament. At such a turning point, clear thinking must prevail and a special set of skills must be applied.

If there is a qualified leader within the company, then delegate the job of turnaround to that person, and provide proper support. If there is not a qualified leader in the company - and there usually isn't - don't hesitate to go outside the company to locate a professional for this job. The answer is often found in the form of a turnaround specialist.

Different Needs

What guides the decision of choosing a leader at this juncture? Different companies have different needs. The CEO that managed the company into trouble clearly is lacking the skills to doctor it back to health. Why risk allowing the same person to try again? Conversely, the CEO that can bring a troubled company from the brink of failure may not have the skills to become the "Marquis" to manage long-term, day-to-day operations.

This suggests a two-part strategy, an interim executive to manage the transition, followed by a well-qualified permanent leader when the time comes.

A troubled company is like a patient in critical condition, decisive steps must be taken to make something happen. The first goal in an absolute crisis is to stabilize and buy time. After steadying the vital signs, take a reading on where things stand - which is normally still. Look for changes in ratios and trends to determine what is - or more important - what is not going on in the business.

Let's put leadership roles into perspective. Requirements differ between those for healthy, growing companies and those in troubled or transition situations. Compare the differences in our chart.

Healthy company. In the stable or growth scenario, there is time for structured growth and building the organization. In a healthy company, management focuses on long-term objectives, coaching, and team building. A manager in a stable environment should be known among shareholders and employees for consistency in decision-making. With the luxury of time, the occasional mistake generally will not do lasting harm.

Turnaround situation. In the initial crisis and subsequent turnaround situation, time is an enemy. The focus is different. In a financially distressed company, the lack of time requires action. As the company's problems compound cash flow evaporates, it becomes critical for management to act quickly and decisively. Management must focus on short-term survival. A manager in a troubled company must be able to shift gears to deal with daily crises that inevitably occur. Troubled companies have primarily one goal - to survive and get well. If the symptoms persist with no cure, the patient can die.

Shortcomings

The difference between long-term planning and short-term decision-making is one reason why the troubled environment is so foreign to many managers. This often explains the difficulty in finding qualified talent for a turnaround within the company. Another problem faced when the company is slipping into trouble is that existing management often goes through a "denial" phase. They tend to blame their situation on external factors, such as the lender's refusal to advance additional funds, rather than examining the way they are managing the company.

When a company is faced with these types of shortcomings in its internal talent pool, it is time to look to a specialist to orchestrate the change needed to save the company.

The Turnaround Specialist

Turnaround specialists generally are either interim managers or consultants. Interim managers will replace the CEO, take the decision-making reins, and guide the company through troubled waters, hopefully to safety. Consultants advise management, possibly the same management that got the company into trouble in the first place. Whether a consultant is effective depends upon management's willingness to listen and implement the specialist's recommendations.

Be assured there are countless cases where existing management agreed to work with a turnaround consultant only to placate the board. There is no substitute for qualified leaders with decision-making authority.

When hiring a turnaround specialist:

- check the person's references
- review proposals versus what can realistically be accomplished
- require engagement agreements, and
- hire an individual, not the firm - personal chemistry with the managers is critical.

The Process

Along with specific skills and an understanding of troubled situations, the specialist offers a new perspective from which to independently evaluate the company's circumstances. The process will focus on several issues:

- Is the business viable?
- What is the purpose of the business?
- Should it be saved? Why? Are reasons valid?
- Is there a core business that can be the source for the emerging business?
- Are there sufficient cash resources to fuel recovery?
- Which existing managers are capable of leading parts of the company?

Remember, not all companies are salvageable.

The fact-finding must proceed as quickly as possible so that a realistic assessment of the current state of the company can be prepared. The specialist's first priority will be to manage cash flow - to stop the hemorrhage. Analysis of sales and profit centers, and asset utilization should indicate where the real problems - not the symptoms - are located. Next, a business plan outlining and suggesting possible courses of action - or cures - will be prepared.

Following a diagnostic stage, the transition can begin towards turnaround. Once a course of action is chosen, implementation and monitoring can occur. The specialist should remain involved at least until the business is stabilized, preferably until the transformation is complete and a new leader is found.

Keep Business Moving

The turnaround specialist needs to get things moving again. Movement must occur in two areas.

Volume in (revenue/sales). Look at where and how revenue is generated. Is it from existing customers and contracts or new business? Most important, keep it coming in.

Volume out (throughput/production). Look at getting the product or service "out the door." How else can you bill for it?

Companies often get into trouble because management procrastinates when it comes to making decisions. If the decision is made by default, it is akin to making no decision at all. Survival for the troubled company depends on being immediate - on making decisions in a timely manner. Even a wrong decision allows movement and direction. If a decision turns out to be wrong, change it, but keep things moving.

Authority and Talent

Time is also a consequential dimension when it comes to authority. In a stable company, there is time to delegate and nurture the growth of the management team and time to work on long-term issues and projects. In the troubled situation, delegating takes on a different role. Managers must be held accountable not only for performance, but also for timely results.

Remember that the good managers may have deserted the ship long ago, leaving behind the second string. The good leader will know how to exploit the talents of these employees and bring them up to a new level to save the company.

In a troubled situation, the decision-maker must get directly involved. It is hard to worry about the long-term future when there may not be one. The leader is pressed closer to the immediacy of the day-to-day operations. If you want action, request a decision or make one.

In a stable situation there is time to develop talent. But at a troubled firm, you must exploit the talents of those who can perform and recruit the talent that is lacking. It means building a permanent management team that can bring a company back to health - and adds value to the company.

Contrasting Leadership Styles

Attribute	Healthy Company	Turnaround Situation
Focus	Objectives	Survival, action, problem solving
Decision making	Deliberateness	Speed, decisiveness
Authority	Delegation	Direct involvement
People	Skills (develop)	Talent (recruit)
Respected for:	Management reputation	Financial credibility
Known for:	Consistency	Ability to shift gears

Communication

Communication is critical with everyone who has a stake in the company's success. Talk to employees, but more significantly, listen to what they have to say. Be assured they know when problems exist. They also often know how to resolve them.

What message are you sending? Remember, what is not said is often more destructive than what is. Unnatural actions or behavior, such as "closed door meetings," will most certainly set off the rumor mill. People need to know or they're left to their own imaginations - and that is always worse.

Equally vital, level with people - then get the stay versus go decision. To address the issues in a forthright manner is no guarantee that you will keep everyone, or that everyone will believe what has been said. But to not communicate what is going on is a lack of leadership, so don't be surprised when employees don't do what you want them to.

Financial Support

A key element to a successful turnaround is to establish a good relationship with your bank. Capital is always required in tough times, not to mention that it's nice in good times as well.

If the leaders who were in power while the company's position was allowed to deteriorate are still there, why should a lender believe that they would now be instrumental in correcting the situation?

To make matters worse, in the eyes of management, the lender can be viewed as an enemy instead of a key part of the turnaround equation. With all the suspicion that can surround a troubled company, it is important that trust be re-established with the bank. Credibility with lenders is mandatory to success - and to keeping that cash flow at the bank. Since the bank holds the trump card, the institution must feel comfortable working with the turnaround leader. It means laying everything out on the table to keep the situation honest - and honoring commitments made to the lender.

Conclusion

Where consistency is important in a stable environment, the name of the game in a turnaround situation is uncertainty. You can absolutely count on surprises. "When it rains, it pours" may be clichéd, but when applied to a troubled company, one can be sure "Murphy is shaking the clouds."

The ability to deal with change at rapid pace is essential. This is why a seasoned practitioner can be the answer to a successful turnaround plan, they've 'been there, done that.' The existing leadership is often 'out of its element' as it enters this untrodden ground of trouble. When people haven't had to manage in this environment before, the odds are that they will at the very least, have a difficult time.

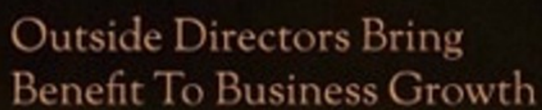
Turnaround leaders didn't start out as such - they were often managers that worked their way up the corporate ladder through hard work and (hopefully) fair play to build a solid management reputation. They have also developed a set of skills to handle problem solving, getting results with minimal resources, (tight) cash flow management, negotiating and dealing with bankers, investors, and creditors. The stakeholders will usually work with a turnaround leader - if he or she is credible.

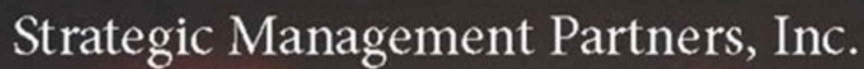
The turnaround specialist must possess the skills to deal with a financially troubled company and have the ability to make the tough decisions needed during a recovery. Specialists are hired for their management ability - the ability to bring order out of chaos, marshal resources, and maximize value from those diverse resources. If the company requires special expertise, then the specialist will attract that expertise. Remember, experience in dealing with crises and change may be more important than industry experience.

The specialist must be financially credible and honor commitments. The company, bank, and other interested parties should be able to rely on the specialist to protect their interests while providing them with accurate information they need on a timely basis. The earlier trouble is detected, the more probability of turnaround success. Affecting a turnaround takes an array of skills. To affect rehabilitation, the right leader will know how to make decisions, put a plan into action, and create a talented team to move towards a healthy and more valuable end.

Finally, a good turnaround specialist will develop a permanent management team within the company to preserve value, instead of hiring a large team of outsiders who, when they leave, take that value with them. The specialist should work themselves out of a job to be most effective, while leaving the company with the ability to grow and prosper as a stand-alone going concern.

***John M. Collard**, chairman of Strategic Management Partners, Annapolis, Maryland. A past chairman of the Turnaround Management Association, Collard advises private equity and institutional investors, company boards of directors, and provides interim executive leadership. (410) 263-9100 www.StrategicMgtPartners.com*


Outside Directors Bring
Benefit To Business Growth

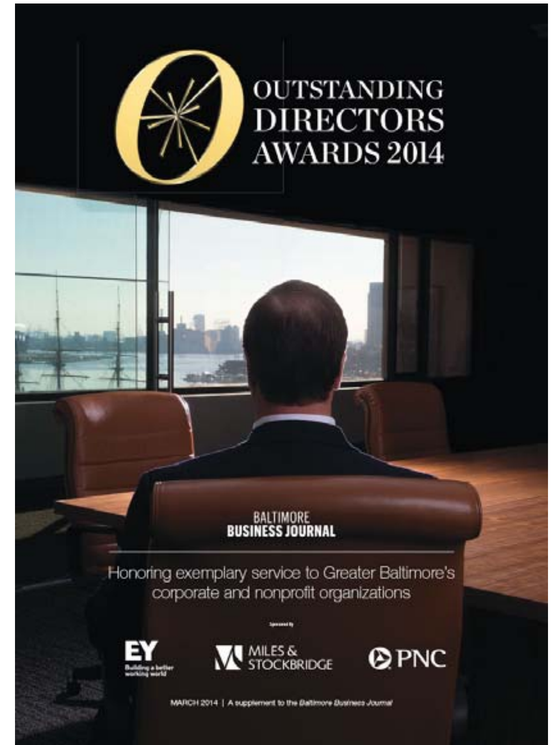

Strategic Management Partners, Inc.

CEO leadership
asset and investment recovery
corporate renewal governance
private equity advisory
recovery fund management
investing in distressed troubled companies
www.StrategicMgtPartners.com

Outside Directors Offer Valuable Guidance, Contacts

By John M. Collard

OUTSTANDING DIRECTORS AWARDS 2014



Outside directors, sometimes referred to as independent or non-executive directors, are advantageous. They rarely have conflict of interest and they often see the big picture differently than insiders.

While corporate governance standards of public companies require a certain number or percentage of outside directors, private companies are normally left alone. But, I highly recommend that unbiased advice even for private companies.

While there is formality, liability and greater cost to a board that brings in outside voices, there is a budget-friendly alternative in the form of a board of advisors that is beholden to management. The main difference is where the fiduciary duty lies: to the shareholders or to management.

Regardless of which vehicle you use, there is great value to hiring an outside director.

With a board of directors, your company immediately gains legitimacy, and a panel with expertise that you probably don't have in-house. Selecting board members from the business community also can bring increase awareness of your company.

When CEOs only listen to yes-men, they are essentially on their own, and new ideas don't enter the decision process. You want strong board members who are not afraid to offer advice, guidance, feedback, and argument on issues.

Employee board members may be in fear of losing their job if they speak up. Alternatively, outside directors should constructively challenge and contribute to strategy development, implementation, and infrastructure.

The board is the perfect way to help set aside your tactical perspective, and force you to work on strategic business issues.

Planning requires fresh thinking and business analysis, even if the result in some areas is to continue business as usual. The value is in the process, which requires all participants to think through and understand the strategy.

Another attribute board members bring is contacts. Your contact book doesn't include everyone. Every company needs help when it wants to grow, prosper or turn around.

Outside directors can extend the company's reach by using their own contact network, including colleagues who can provide guidance and resources.

Outside directors often have a database of contacts who can supply capital, both in the form of debt (lenders) and/or equity (investors). This means that you can get in front of many financing resources quickly once an expression of interest or offering package is ready.

Like with raising capital, outside directors also often have databases of contacts who both have deals for acquisition and who are looking for opportunities to buy. This means that you can get in front of M&A dealmaker resources quickly once an offering package is ready.

Prepare for that future liquidity event. The best time to sell a company is when a buyer wants to buy and has cash, which could come when you don't expect it.

Be prepared and work toward ultimate valuation throughout the process of growth.

Outside directors are often adept at introductions and negotiating deals. They then elevate you (management and the board) to the decision-making role.

Hire that outside director. **bbj**

John M. Collard, is Chairman of Annapolis, Maryland-based Strategic Management Partners, Inc., a turnaround management firm specializing in interim executive CEO leadership, asset and investment recovery, corporate renewal governance, investing in and rebuilding underperforming distressed troubled companies. He is a Certified Turnaround Professional, Certified International Turnaround Manager, Past Chairman of the Turnaround Management Association, Chairman of Association of Interim Executives, Senior Fellow at Turnaround Management Society, and serves on public and private boards of directors. He is an advisor to companies and private equity investors. Participated in 45 M&A transactions worth $1B. He was inducted into the Turnaround Management, Restructuring, Distressed Investing Industry Hall of Fame. He received Interim Management Lifetime Achievement Award. He can be reached at 410-263-9100 or *John@StrategicMgtPartners.com*

6 Ways Outside Directors Benefit Business Growth

By John M. Collard
Strategic Management Partners, Inc.

PRESIDENT&CEO
meet in the middle™

You Need These Guys.

An outside director is a member of the board of directors or advisors who is not part of the executive management team. These professionals are sometimes referred to as independent or non-executive directors. They are not employees of the company and are differentiated from inside directors, who do serve as executive managers and/or corporate officers.

Outside directors are advantageous because they rarely have conflict of interest and they often see the big picture differently than insiders. While corporate governance standards of public companies require a certain number or percentage of outside directors because they are more likely to provide unbiased opinions, private companies are normally left alone — but, I highly recommend that unbiased advice.

In today's business environment, smart organizations frequently seek outside expertise. Traditionally, companies invited advisors to join their board of directors. There is now, however, more risk to these directors based upon recent legislation (Sarbanes-Oxley). While there is formality (shareholder reporting, responsibility, risk), liability, and more expense (D&O insurance, etc.) to a board of directors, there is a budget-friendly alternative in the form of a 'board of advisors' that is beholden to management. The main difference is in where the fiduciary duty lies: to the shareholders or to management. Regardless of which vehicle you use, there is great value to be obtained by hiring an outside director.

Why add outsiders to your board of directors or advisors?

1) Outside directors can be a low-risk, low-cost, but valuable resource. They bring a new set of skills that will produce benefit for your company.
2) Outside directors are on your side. Unlike other outsiders to whom even a private company must answer, like banks and insurance companies, the IRS, OSHA, EPA, etc., these advisors answer to you.
3) Outside directors add credibility. When it comes time for a liquidity seeking event, like new financing, selling the company, or IPO, outside directors send the message that you are a professional serious organization with guidance.

With a board of directors, your company immediately gains legitimacy, and a panel with expertise that you probably don't have "in-house." Selecting board members from the business community can also bring greater awareness of your company.

Create a culture and structure that will withstand third-party accountability. Start thinking as a serious growing company and prepare for a potential future life as a public company.

Independent Perspective

The day-to-day events in a business often distract the CEO's time and energy. It is easy to get wrapped up in the ways and means of running the operation, while losing track of the bigger picture. The sounding board provided by an outside advisor can certainly help ground the CEO in real leadership duties. Typically, a board will focus on protecting the unique value of the company, but they often add much more.

CEOs need advice from outside directors who care about the company's success, and can view things from a distance and a different perspective. CEOs will be well served by adding board members who can challenge them and the decisions they are about to make. When CEOs listen only to people who say "yes," they are essentially on their own, and new ideas don't enter the decision process. You want strong board members who are not afraid to offer advice, guidance, feedback, and argument on issues. Employee board members may be in fear of losing their job if they speak up.

Create the opportunity for people to disagree with you and confront your thinking. This is a must if you want to grow. Honest debate from knowledgeable people, who are on your side, will produce results that you can rely on. If you fear this approach, what are you hiding? Smart people learn from advisors who don't threaten their position, hence the need for outside independent thinkers.

Strategic Thinking & Planning

Outside directors should constructively challenge and contribute to strategy development, implementation, and infrastructure. The board is the perfect way to help set aside your tactical perspective, and force you to work on strategic business issues.

Planning requires fresh thinking and business analysis, even if the result in some areas is to continue business as usual. The value is in the process, which requires all participants to think through and understand the strategy. Put in place contingency plans for those events that we hope will never occur, but somehow always do happen.

Once strategy is set you have defined where you want to go. Now communicate that message for all stakeholders to see and understand by using a mission or direction statement. There is nothing quite so effective as designing compensation and incentive plans that are paid out when goals are met, but, don't pay for nonperformance. Incentive-based management is extremely effective, but be cautious that you have set the right goals, because if not, employees will take you in unplanned directions.

Experience & Objectivity

The very nature of growth implies that a company is going where it has not been before. It is refreshing to take that journey

Benefits of Outside Directors

ACTION/SKILL	BENEFIT
Independent Perspective	Challenge Management, Sounding Board
Strategic Thinking & Planning	New Direction, Transitions, Incentive-Based Compensation
Experience & Objectivity	Been There, Done That, Oversee Performance & Risk
Contacts	Partners, Customers, Suppliers, Personnel, Lenders, Investors
Capital Infusion	Raise Money, Restructure, Create Offering Package
Transactions	Prepare Company for Sale, Negotiate the Deal

to new opportunities with the help of an advisor who has been there and done that before. Their objectivity can help you through the obstacles.

When independent observers scrutinize the performance of management in meeting goals and objectives, and monitoring results compared to long-term valuation goals, there is real value in their participation. Outside directors should satisfy themselves that financial information is accurate, that financial controls are in place, that internal reporting is at the right levels and prepared often, and that risk management systems are in place. Make sure that the company complies with laws and regulations.

While most companies follow a well understood life cycle, it is extremely helpful to distinguish between crises that are normal based upon their stage in that life cycle versus crises that are troublesome because they are unexpected. Look for business advice from experts who have experience in these situations.

When transitioning into new markets it helps to have someone on your team that has both gone through transitions before and understands the idiosyncrasies of the new market. For instance, doing business with the federal government is quite different than doing business in commercial and international markets. If you want to enter into new markets have team members with diverse experiences to help guide the way.

Contacts

Every company needs help when it wants to grow, prosper, or turn around. Your contact book doesn't include everyone. Outside directors can extend the company's reach by using their own contact network of colleagues that can get involved to provide guidance and resources.

Rely on these contact introductions to bring in new customers, which will drive sales revenue. New suppliers can favorably impact cost-cutting of materials, which drive a better bottom line. Strive for strategic teaming relationships to promote growth.

Contacts can be influential in bringing resources not previously available. They can attract new talent into the company at all levels and provide a new set of eyes and ears during the interview process. Locate other independent directors. Improve the management team. Grow the sales force and distribution channels. Introduce and improve marketing, penetration, and Internet presence strategies. Entice operational experts to produce product and services. Lure innovative people who can embellish research and development.

Capital Infusion

Outside directors often have a database of contacts who can supply capital, both in the form of debt (lenders) and/or equity (investors). This means that you can get in front of many financing resources quickly once an expression of interest or offering package is ready. The key is to document the plan describing where you want to go and why you will succeed, put that in summary and detail form, describe assumptions and risks, and present rate of return projections. In other words, present your opportunity in terms the investor or lender wants to see —you are the product. Investors are in this for a return on their investment.

You will need financial history of operations and projections of future plans to satisfy the stringent criteria of financing sources. Begin this process early so that you are prepared when the time comes. I favor a two-page (executive introduction), 10 page (present the deal opportunity), due diligence (details) approach, to step potential interested parties through the process.

Prepare for that future liquidity event. The best time to sell a company is when a buyer wants to buy and has cash, which could come when you don't expect it.

If a turnaround is in process the task is more complex. While there is an overabundance of capital available, you will have to demonstrate that you have indeed made changes at the company. Changes in management, control systems, strategy, etc. are a must. A board of directors demonstrates that you are up to the task of reporting to an outside financing entity.

Transactions

Like with raising capital, outside directors often have a database of contacts who both have deals for acquisition and who are looking for opportunities to buy. This means that you can get in front of M&A dealmaker resources quickly once an offering package is ready.

Prepare for that future liquidity event. The best time to sell a company is when a buyer wants to buy and has cash, which could come when you don't expect it. Be prepared and work toward ultimate valuation throughout the process of growth.

Outside directors are often adept at introductions and negotiating deals. They then elevate you (management and the board) to the decision-making role.

Hire that outside director. PRESIDENT&CEO

John M. Collard, is chairman of Annapolis, MD-based Strategic Management Partners, Inc., a turnaround management firm specializing in interim executive CEO leadership, asset and investment recovery, corporate renewal governance and investing in underperforming distressed troubled companies. He is a certified turnaround professional, certified international turnaround manager, past chairman of the Turnaround Management Association, chairman of Association of Interim Executives, and serves on public and private boards of directors. He is an advisor to companies and private equity investors. Participated in 45 M&A transactions worth $1B. He was inducted into the Turnaround Management, Restructuring, Distressed Investing Industry Hall of Fame. He can be reached at 410-263-9100 or *John@StrategicMgtPartners.com*

Quick Leadership & Benefits of Interim Managers

C-Level Executives Can Make the Difference

By John M. Collard

If you have an extraordinary innovation, opportunity or even a unique situation, an interim executive can help launch, grow, or turnaround your venture by temporarily filling one or more key management roles in your company. Whether they serve as your interim chief executive officer (CEO), chief restructuring officer (CRO), chief operating officer (COO), chief financial officer (CFO), chief selling officer (CSO), chief manufacturing officer (CMO), chief whichever officer (CXO), general counsel or in some other senior executive role, they can stand by your side as an experienced executive with a vested interest in your long-term success.

Experienced management is one of the most important factors behind the success of any business. Many managers have ample enthusiasm and energy, but often lack the knowledge and experience needed to sidestep easily avoided mistakes. As a result, far too many companies get into trouble and can die before ever reaching their potential market value.

If you have an extraordinary innovation, opportunity or even a unique situation, an interim executive can help launch, grow, or turnaround your venture by temporarily filling one or more key management roles in your company. Whether they serve as your interim chief executive officer (CEO), chief restructuring officer (CRO), chief operating officer (COO), chief financial officer (CFO), chief selling officer (CSO), chief manufacturing officer (CMO), chief whichever officer (CXO), general counsel or in some other senior executive role, they can stand by your side as an experienced executive with a vested interest in your long-term success.

Interim C-level executives are experienced managers who have launched and grown successful ventures. As your partner, they roll up their sleeves and work towards laying the groundwork for a successful venture. They work hard, because they succeed only if you succeed.

In a typical engagement, the Interim Executive will form an executive management team (often using some existing resources) and take over much of the managerial control of the situation, allowing you to focus on what you're best at: investing in other companies, managing other ventures, product innovation, etc.

Interim Executives are typically hired by private equity investors, board of director members, corporate council and sometimes the management team or CEO. Headhunters are often used to locate these interim execs for special situations. Hiring a new Interim CEO will take board and/or investor action to make the change.

What is Interim Management?

Interim Management is the providing of senior C-level management resources on a temporary basis to organizations that require an immediate, short-term need. There are a number of factors that appeal to companies when considering using interim management services, including responsiveness, experience, objectivity, project duration, and the list goes on.

Benefits of Interim Management

ACTION/SKILL	BENEFIT
Speedy Deployment	Talent on scene in days; flexible term
Experience Means Results	Highly qualified and experienced resources
Objectivity	Fresh perspective
Accountability	Delivery of objectives
Effectiveness	Board-level reporting gives authority to effect change
Commitment	Get control, put plans in place, find their replacement and leave when project ends

Interim Managers have become a powerful resourcing option in today's fast paced business environment. The key benefits that an interim manager brings on assignment to a company can be summarized here.

Speedy, Responsive, Flexible Deployment of Resources

Interim manager talent can be in place within days as opposed to weeks or months, which is essential when time constraints are critical. Interim management is a quick solution to bring resources onboard, deploying those who are fully and properly skilled to deliver service required.

The very nature of interim management means the greatest flexibility from a client perspective including the extension, expansion, or termination of the services. There is no impact to succession planning because interim managers are not permanent resources within the organization, therefore their position does not pose any threat to internal resources and associated succession planning processes. There is also no impact to permanent headcount because interim management provides a solution when clients are constrained on permanent headcount, but still must deliver business objectives.

Interim manager talent can be in place within days as opposed to weeks or months, which is essential when time constraints are critical … a quick solution to bring resources onboard, deploying those that are fully and properly skilled to deliver the service required.

Experience Means Rapid Results

Interim managers are highly qualified, experienced, and able to produce as soon as they arrive on scene. Due to their skill level and expertise, these resources will be fully productive in a matter of days. This over-qualified tendancy is well suited for project work because it focuses on achieving results and gives clear definition of key milestones, regular progress reports and measurement of performance.

Interim managers are more than qualified for the positions they are taking on, and therefore are often stepping down in responsibility. Interim managers have past experience of similar challenges to the ones that they are about to face. In addition to enabling them to have an immediate effect and be productive from the outset, this experience ensures success. They will transfer their skill and experience to your team.

Objectivity

Interim managers provide a fresh perspective and are free to concentrate on what is best for the business. Interim mangers are free from any previous involvement in company processes, staff relationships, office politics or career advancement goals. Interim managers identify problems and implement new solutions that may not be visible to company insiders because they are too close to the issue.

Accountability

Interim managers will take full, direct, and primary accountability for the assignment including delivery of objectives, budget control, resource management, on-time delivery, etc., in accordance with scope of the assignment.

Good interims embrace the challenges of different and difficult assignments, take great pride in maintaining the highest standards and realize that the next job is dependent on the success of the current assignment.

Rather than adopting a purely advisory role, as would a management consultant, interim managers become the responsible and accountable line managers that will take ownership and manage a business or implement a project to success.

Effectiveness

Operating at or near board-level gives interim managers the authority to effect significant change or transition within a company; unlike a temp, they're not just there to manage the status quo. Interim managers are hired as agents of change to make things happen quickly and because they bring skill-sets that probably are not available within the company.

Commitment

Interim managers are committed to an interim career, and each assignment is never just a stop gap until a suitable permanent position is found. Good interims embrace the challenges of different and difficult assignments, take great pride in maintaining the highest standards and realize that the next job is dependent on the success of the current assignment.

Good interims will get control of the situation, put plans and resources in place to run the company, find their replacement if necessary, and leave when the project ends or the company is turned around.

Value to the interim manager process includes bringing expert management, getting results quickly, operating in a flexible environment, all while allowing you to go about the business that you do well. Interim engagements are by definition for a period of time and staffed by a non-employee, therefore avoiding labor laws that apply to employees. This is an advantage in many parts of the world where labor laws are very strict regarding benefits and burdensome severence policies, in contrast to the at-will nature of the United States.

Hire that Interim CxO. abfj

John M. Collard, is chairman of Annapolis, MD-based Strategic Management Partners, Inc., a turnaround management firm specializing in interim executive CEO leadership, asset and investment recovery, corporate renewal governance and investing in underperforming distressed troubled companies. He is a certified turnaround professional, certified international turnaround manager, past chairman of the Turnaround Management Association, chairman of Association of Interim Executives and serves on public and private boards of directors. He is a frequent author, speaker and advisor to companies, institutional and private equity investors and governments. He was inducted into the Turnaround Management, Restructuring, Distressed Investing Industry Hall of Fame. He can be reached at 410-263-9100 or *John@StrategicMgtPartners.com*

John M. Collard

Raising Money In Tough Times

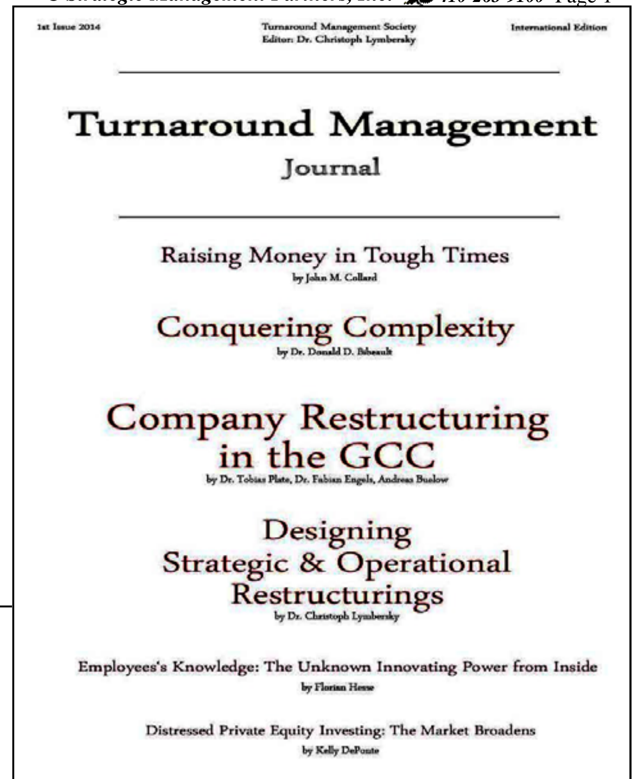
Easier Than You May Think

By John M. Collard

Chairman of Strategic Management Partners, Inc.

Senior Fellow of the Turnaround Management Society

Certified International Turnaround Manager (CITM)



1st Issue 2014 | Turnaround Management Society Editor: Dr. Christoph Lymbersky | International Edition

Turnaround Management Journal

Raising Money in Tough Times
by John M. Collard

Conquering Complexity
by Dr. Donald D. Bibeault

Company Restructuring in the GCC
by Dr. Tobias Plate, Dr. Fabian Engels, Andreas Buslow

Designing Strategic & Operational Restructurings
by Dr. Christoph Lymbersky

Employees's Knowledge: The Unknown Innovating Power from Inside
by Florian Hesse

Distressed Private Equity Investing: The Market Broadens
by Kelly DePonte

Private equity funds use a 'funnel approach' viewing 1,000 deals to find 100 worth a deeper review, which result in one or two worth their investment. To present the company in the most favorable light the business operating plan must describe the opportunity to investors and what is in it for them.

I have yet to enter a turnaround situation that I didn't hear the owner or CEO or the board say that the answer to all of their problems is more money. While in some cases this is a real need, it is seldom the systemic problem within the company. Chances are that they have some work to do. Needing 'dollars' is one thing … being ready to raise 'dollars' is another.

There is an abundance of funding available in the marketplace for good deals. The key wording in this statement is of course "good deals." When a company is in trouble rarely is it considered a good deal without some fixing.

Don't be surprised when you come to the realization that the company isn't attractive to investors or lenders. This means that you have the opportunity to rebuild the company, or parts of it, so that it can be considered a "good deal." Build a company that investors want to invest in.

Buyers and Investors Look For:

- *Businesses that create value.* Consistency from period to period.
- *High probability of future cash flows.* History of performance and improvement, or the promise of cash. Lenders want their interest and the repayment of principal. Troubled entities must be on the mend and making progress.
- *Market-oriented management team.* Focus on producing revenue. Cost cutting is only a temporary fix, you must generate revenue to make growth viable.
- *Ability to sell and compete; develop, produce, and distribute products; thrive and grow.* Track record or demonstrated changes in the right direction. Make certain that the problems are fixed.
- *Fair entry valuation.* Realistic return potential is a must to attract investors.
- *Exit options.* Lenders want their interest and the repayment of principal. Investors want ROI multiples.

Raising Capital

Once the company is rebuilding and perhaps restructured you are ready to raise capital. With technology available today the Internet can be a valuable resource to get in front of many interested investors. Approaching one investor at a time can be very time consuming. The risk of finding the right one early in the process is very high. Often the answer lies in casting a wide net to 100s and 100s of investors to solicit interest.

Private equity funds use a 'funnel approach' viewing 1,000 deals to find 100 worth a deeper review, which result in one or two worth their investment. Lenders go through a similar process. Be either #1 or #2.

To present the company in the most favorable light the business operating plan must describe the opportunity to investors and what is in it for them. Why will they invest in you? To finance transition the plan must detail how you are fixing systemic problems and will use the funding for that purpose. Treat the potential investor as your audience where the product is your company.

© Copyright 2014 by Turnaround Management Journal & Strategic Management Partners, Inc.— Reprinted with permission

Business Operating Plan Includes:

- *Executive Summary.* Catch the interest of prospective sources of financing. Position the company accurately and distinguish your concept from others competing for money.
- *Business History.* Who founded the company, when, capital structure, and progress to date. Openly discuss why the company is in trouble and why and how it is being fixed. What sound reasons support a change in performance — for the better.
- *Product/Service.* Define precisely what you develop and/or market. What customer need does your product satisfy and how? Why will customers buy from you? What distinct competencies do you offer?
- *Market.* Who are your customers? Why will they buy the product? Trends in customer purchases? How will you sell to the market? What are critical product characteristics?
- *Competition.* Identify specific competitors' strengths and weaknesses. Principal competitive factors in the marketplace? Where will your market share come from? How will you convince buyers you are worthy of their trust?
- *Marketing.* Define strategy and chart the marketing direction for your staff. Give prospective investors confidence that you can convert ideas and assets into a strong marketing position and stream of profits. Be prepared to market why customers should trust your recovery. Discuss distribution channels, pricing strategy, promotion, and sales incentives.
- *Manufacturing and Operations.* What is the nature, quality, extent, and efficiency of production facilities. What is capacity and utilization?
- *Management.* Emphasize the experience and competence of the key management team members. What changes have been made, are planned and when. In a troubled company changes are required. How are executives compensated and incentivized?
- *Financial Projections and Assumptions.* Past, present, and future balance sheet, income statement, cash flow statements. Most importantly, investors want to validate your assumptions.

Your business plan is only as good as the intelligence and work you put into it and the uses that you make of it. The plan must persuade your team and prospective investors that your concept merits their consideration and buy-in.

Think about it, no one wants their investment or loan to pay for past sins. The capital infusion must be used to take the company forward. Address in detail why the company got into trouble, how you are fixing the problems, and how the new capital will be allocated to these efforts. How do you plan to handle, preferably avoid old obligations while rebuilding the company?

Three Step Approach to Get Results and Money:

1. Send a *personalized* letter to solicit interest to many investors and lenders. Include a 2-3 page Overview of the transaction. This letter should go to 100s of potential investors. Email Merge works very well for this task.
2. When you receive responses of interest immediately send a 10-12 page Executive Summary to detail the opportunity.
3. For those with continued interest present them with a detailed Operating Plan including the assumptions and financial forecasts for use during due diligence investigations. Be prepared for their detailed investigations.

It is very important that the Overview, Executive Summary, Operating Plan, and due diligence all be prepared and ready, subject to revisions, before the Emerge process begins. When you attract an interested investor they will move very quickly. If you are not ready to respond immediately they will move on to the next opportunity in their funnel. Dedicate executives and be prepared to schedule personal meetings to answer questions and close the deal.

Most turnaround specialists will have a list of investors and lenders who are looking for deals, some have longer lists than others. These specialists can help the process of preparing the solicitation documents, perform the Emerge to locate investors, and negotiate the transaction.

Compensation for the money raising process varies by specialist, but there will be fees for preparing the process and a Finder's Fee upon completion of the transaction. Most specialists will use a Modified Lehman Formula geared to the size of the deal. One example of a Modified Lehman Formula might be 7.5% fee for first $1 million involved in the transaction, 6.0% for next $1 million, 4.5% for next $1 million, 3.0% for next $1 million, and 1.5% fee for the remainder of the transaction. Because there is a similar amount of work to locating financing for smaller deals as there is for larger ones expect the percentage fee to be higher for smaller deals.

It is not hard to raise money if you put the right tools in place and the deal is investable. Be the "good deal" and you will raise capital.

John M. Collard, Chairman, Strategic Management Partners, Inc., an Annapolis, Maryland, USA-based turnaround management firm specializing in interim executive CEO leadership, asset and investment recovery, outside director governance, raising capital, private equity advisory, recovery fund management, and investing in and rebuilding underperforming distressed troubled companies. He is a Certified Turnaround Professional (CTP), Certified International Turnaround Manager (CITM), Past Chairman of the Turnaround Management Association (TMA), Chairman of the Association of Interim Executives (AIE), participated in 45 transactions worth $1B. John is an inductee into the Turnaround Management, Restructuring and Distressed Investing Industry Hall of Fame.

www.StrategicMgtPartners.com
Telefon: 410-263-9100

Mission Possible: Six Questions Your Mission Statement Should Answer

By John M. Collard

The BMDO Update
National Technology Transfer Center

When was the last time you read your company's mission statement? What did it say to you? More importantly, what does it really convey to others? Thousands of businesses have mission statements, but few have mission statements that serve their intended purpose. Where is your company going? What does it do? These words are supposed to inspire and guide you and your employees every working day and hour, whether your business is coming up ahead, lagging behind, or just sitting in the middle.

Yet all too often, a mission statement comes up short; it may say something nebulous such as, "The mission of our company is to provide excellence and quality for all of our customers." While these ideals are fine, they are basically expected. Most managers acknowledge that the company that they work for is going to want to provide excellence and quality for all of its customers. The words do not give constructive guidance to management and professionals in their daily work lives. And a customer reading such a plaque over the receptionist's desk doesn't really get a feel for what the company does or why it is different from its competitors.

The role of the mission statement is to provide the planning team, management, employees, customers, all stakeholders, with an understanding of future growth directions. Somewhere in its body, it should include all six descriptive, directive, and explanatory components as highlighted:

1) Product and its benefit to the customer: What do we do or provide? What is the product line's breadth, attributes, and price and quality level (i.e. high-end vs. economy-version)?

2) Technology: How will we deliver our services? What technologies are you using to deliver your services? Using many technologies can increase your required investment in the business. However, there is a balance because complimentary technologies sometimes can be an indication of controlled flexibility, innovation, and lower manufacturing costs through economies of scale and a pooled labor force.

3) Levels of vertical integration: How much will we do? Which customer needs will, and will not, be satisfied? What degree of penetration will we use to satisfy the customer's entire need? Resources will not allow you to be all things to all people. Defining your boundaries will indicate where you need to develop new products, seek partners, or avoid competition.

4) Generic customer needs: Why will they buy? Defining generic needs will help you identify strategic alliances and marketing approaches that are more likely to be successful. If you can only supply a small portion of the total market need, you need to define growth areas.

5) Market definition: Who will you sell to and where? Define the scope of the market. This section allows you to develop different strategies to address multiple directions, yet accommodate your common goals.

6) Distinct competencies: Why will they buy from you? Differentiate yourself from your competition. Define and focus on those innovations and capabilities that give you an edge over your competitors. This will help you define where your highest profit and cash flow margins are and will indicate the areas where you may need to invest to maintain your advantage.

So, your next mission may be to write a new mission statement-or maybe not.

© Copyright 2010, Strategic Management Partners, Inc.

Mission Statement Examples

Highlighted below are critiques of a few mission statements, some of which you may recognize. Note that in some cases the six elements may be implied, especially when the company is a household name.

"We provide pick-up and on time delivery of important documents worldwide"

Very good. The service is one of delivery to a worldwide market. But not of all customer shipments, only that of small packages on an urgent basis. On time talks to the issue of reliability. While the specific of how isn't discussed, it is implied that there is an efficient ground and air distribution network in place operated on a continuous basis.

"We provide systems engineering services to the defense department and military contractors"

Not so good. Systems engineering is a vague definition that omits any discussion of specific key deliverables, benefits to the customer, or differentiation from competitors who make the same claim. While at first blush the focus sounds direct, it really lacks focus, and implies a broad range of services, which in turn degrades the credibility. Few small companies are an expert in all aspects of this large customers' requirements. Instead, limiting services to say logistics, satellite imaging, simulation modeling, you name it; provided to the BMDO, Air Force, Navy Air programs, etc. is much better.

"We provide unique application engineering, communications, and systems integration services to federal civilian agencies, departments of the armed forces, and commercial customers with needs in aviation command and control, avionics, and guidance systems"

Pretty good. When there is no definition of 'unique' [it sounds good], it leaves room to question credibility, and begs specificity. There is very direct focus at both customer and product or service offering, albeit at a broad level. It would be better if more limited [i.e. to guidance and communications] offering(s) in this boundless high tech environment. The glaring omission here is the statement of why or how a provider can provide services to both the federal and commercial markets; the market needs and the approach to market and contracting are dramatically different. Small companies should address their niche and state why their product or service meets the needs of such a diverse customer set; when you can, the representatives of business will call you, if you can't, the phone just doesn't ring.

"At Dean Whitter, we measure our success one customer at a time"

Very good. Implies that the firm is successful and growing which gives credibility and encourages investors to come to them. They measure and therefore value success for their customers which is the customers desire, to increase the size of their portfolio. 'One customer at a time' strongly states focus on customer needs and servicing them are important.

"Working hand-in-hand with the communications industry, we deliver low-cost microelectronics solutions today for the wireless products of tomorrow"

Interesting. How can you work with an industry? You work with companies and people that share a part of an industry make-up. Microelectronics today has limitations, how are you overcoming these and what will it do for products? If you define a profound change which will be prevalent tomorrow, you will give yourself more credibility. Hand-in-hand implies closeness, but what is the requirement you are satisfying? Perhaps we are state-of-the-art developers of products, et cetera. However, then you have confusion, because state-of-the-art implies leading edge, and low-cost comes much later.

*The **Update** is published by the National Technology Transfer Center and each monthly edition is received by over 4,000 members of public and privately held companies.*

***John M. Collard**, a certified turnaround professional, is chairman of Strategic Management Partners, Inc., Annapolis, Maryland. A past chairman of the Turnaround Management Association, Collard advises institutional and private equity investors, company boards of directors, and provides interim executive leadership. He has been advisor to President Clinton's National Economic Council, World Bank, European Bank for Reconstruction and Development, and Boris Yeltsin's Russian Privatization Agency.* www.strategist.ws or call (410) 263-9100

© Copyright 2010, Strategic Management Partners, Inc.

businesssense
The Fabricator Magazine

Managing employees through incentive compensation

If you want results, show them the money!

By John M. Collard

Business owners looking to find a way to share the wealth with those required to help create it have an option in incentive compensation (IC). This concept rewards performance and teamwork that produce results.

If you're willing to invest in realistic incentives that reward your managers' and employees' achievements, you'll reap the proceeds. When employees can see dollar signs, and their goals are clearly stated to clarify direction and eliminate confusion, their mindsets change and they become more creative.

The keys to success with IC are to:

1. Set realistic goals and time frames
2. Hold managers accountable for performance
3. Communicate measurement and reward methodology

...and then step back and let them perform.

Incentive Plan

The ultimate goal of the motivational plan is to improve the equity value of the company. Owners accept risk when entrusting operations to the capability, judgment, and decision-making of the people who work for them. Share profits in proportion to the risks being taken.

Include as many employees as possible as part of an incentive-based structure, but realize that each employee will not receive the same amount of compensation. When an employee's income is based purely on performance, as it is in sales, the risk is greater and so should be the possible reward. Employees working under an agreement or union contract governing work behavior and performance will receive a smaller bonus by comparison for achieving their goals. If they want the rewards, they need to share the risk.

Develop an incentive pool based on the amount of gross margin and distribute bonuses based on a weighted average to the team. When the company does well, gross margin improves, thereby increasing the size of the bonus pool, and IC is greater. Tie the incentive at budget to a percentage of salary to help the weighting average calculation.

Pay managers' incentive compensation based 50 percent on what the employees are directly responsible for, 30 percent on how their performance impacts other key departments (for instance, how sales can improve production throughput), and 20 percent on their ability to improve equity value or other elements within their control. The intent is to measure performance and, as important, cooperation among departments and personnel.

Structure a bonus payment scale in accordance with worst, likely, and best scenarios. In the worst case, few bonuses should be paid because goals were not met. In the likely case, pay 40 to 60 percent of the full bonus rate. In the best case, pay maximum bonus rates. The scale is clearly weighted toward higher bonus for greater performance. Communicate progress early and often.

Always be sure to reward positive results when goals are achieved, but never give a full reward when goals have not been accomplished. This type of sliding scale will be looked upon as being fair and will help to motivate people along the way.

Incentive Payments

Distributions should be made on a year to date (YTD) calculation, paid quarterly. So the company doesn't take all of the risk, pay about two-thirds of the YTD bonus at the end of the first quarter, 75 percent at the end of the second, 85 percent at the end of the third, and the remainder at the end of the year.

For example, let's say that the gross margin was enough in the first quarter that the bonus percentage would yield a $250 bonus—a quarter of the ultimate $1,000 yearly bonus. The company owner would pay a first quarter bonus of 67 percent, or $167.50. If the financial numbers for the six months warrant a $600.00 bonus, then 75 percent of that — $450.00 — less the $167.50 already paid, which comes to $282.50 would be given out to each employee.

© Copyright 2010, Strategic Management Partners, Inc.

The gross margin at nine months suggests an $850.00 bonus, which at 85 percent comes to $722.50, less the $450.00 already paid, which would result in a third-quarter payment of $272.50. And if the end-of-the-year numbers call for a $1,000 bonus, $277.50 is paid to each employee because $722.50 has already been paid out. The YTD factor becomes self-correcting, yet allows for slowdown in results without putting the company at risk.

This reserve within the company will prevent early payout for exceptional results without a sufficient catch-up period if these results don't continue. Employees can share in the rewards as they occur rather than waiting until the end of the year — an added incentive.

Plan Specifics

General Management. The general manager must measure the company's real equity value in the same way an investor or potential purchaser would: based on market value of assets, their ability to produce economic value, the ability of the management team to produce cash and profits on a recurring basis, and the ability of the company to produce quality products and maintain customers on a consistent basis.

If all managers make their goals, the general manager will make his or her goals because the equity value will increase. This can encourage general managers to drive volume and throughput well beyond break-even levels and to support their managers to achieve results. For an overview of how the incentive program should be structured for general management and other company departmental areas, see our chart.

Sales. Support the selling process from start to end. If workflow through the plant is level, then overhead as a percentage of sales is reduced, producing greater profits or more competitive rates.

Therefore, it's important to emphasize interdepartmental coordination in your company. Sales can support Production by seeking jobs that fit the plant with flexible delivery schedules if needed. Production can support Sales by over-recovering rates and delivering quality products on time and under budget. Pricing/Estimating can support the whole process by improving the win ratio of jobs bid and by leveling the load to stabilize throughput, thus driving volume.

		Incentive		
Function	**Focus On:**	**50%**	**30%**	**20%**
General Manager	Company Value	Equity Value Improvement	Earnings Per Share [EPS]	Employee Motivation
Sales	Sales Revenue	Profitable Revenue Generated	Consistent/Flexible Work Flow	EPS/ Net Profit
Estimating	Profitable Work	New Business Win Ratio	Consistent Work Flow	EPS/ Net Profit
Production/ Project Mgt	Throughput, Project Profit	Gross/Margin, Resource Utilization	Billing Rate Overrecovery	EPS/ Net Profit
Human Resources	Employee Relations	Employee Motivation	Employee Satisfaction	Low Rate of Turnover
Finance	Financial Cash Flow	Timely, Accurate Information	Overhead Cost Control	Cash Availability

Put salespeople on a tiered commission structure to reward them for new customers and value-added sales. Pay a higher commission percentage for the first 12 months that a customer is with the company, and then reduce the commission percentage, as the customer becomes a recurring customer. This forces Sales to seek new customers, while allowing customer service to grow the existing customer base; a team effort.

Simultaneously put Customer Service on an incentive schedule on top of salaries to drive revenue growth and retention from existing customers.

Sales must focus on helping the plant's throughput. A focus on flexibility and load leveling will serve to fill part of the valleys in slow periods. They must remember that more sales are likely to be produced during off-peak times, while sales during peak times may not.

Production. The best measure of plant throughput is *hours worked versus hours billed*, which means comparing the hours for a job on all the timecards to what is invoiced to the customer. The closer these are to a 1-to-1 ratio, the better the productivity, throughput, and profitability. When the production team goes over on one job, they will be compelled to go under on another to balance the overall ratio for the period.

The whole issue of 1-to-1 accountability will bring to light concerns regarding estimating accuracy, department cost justification, scheduling inequities, flexibility, and the need for volume. It will rebalance the rates and force flexible scheduling to meet throughput demands.

When problems arise, flexibility in delivery time will help avoid just-in-time preparation while driving profitability. The ability to slot another job into production while problems are resolved will maximize yield and eliminate standing around a quiet machine.

When work order hours are out of balance, obtain an adjustment if possible. Customer-approved change orders generate more hours against which to charge time, which can help you get closer to the 1-to-1 ratio. If there is no change order, flag each first occurrence for the Pricing department to factor in — and don't make the same mistake next time.

The End Result

Incentive-based management is a catalyst toward improving direction and creating value.

Tie incentives to your goals to create focus. Motivate the entire work force, allow creative thinking, and gladly pay the bonus when the results improve the equity value of your company.

When the equity value increases, the higher share price improves the value of the investment for shareholders, and you can pay dividends or reinvest in the growth of your company, which often yields even greater returns.

John M. Collard, is Chairman of Strategic Management Partners, Inc., 522 Horn Point Drive, Annapolis MD 21403: a nationally recognized turnaround management firm specializing in interim executive leadership and investing equity in underperforming companies. He is Past Chairman of the Turnaround Management Association, and brings 35 years senior operating leadership, $85M asset recovery, 40+ transactions worth $780M, and $80M fund management expertise to advise company boards, institutional and private equity investors. 410-263-9100 www.strategist.ws

© Copyright 2010, Strategic Management Partners, Inc.

About the Author

John M. Collard is Chairman of Strategic Management Partners Inc. (410-263-9100 www.StrategicMgtPartners.com), an Annapolis, Maryland-based turnaround management firm specializing in interim executive CEO leadership, asset and investment recovery for investors, board and private equity advisory, raising money, recovery fund management, and investing in and rebuilding distressed underperforming troubled companies.

John is Certified Turnaround Professional (CTP), Certified International Turnaround Manager (CITM), an expert who brings 35 years senior leadership, $85M+ asset and investment recovery, 45+ transactions worth $1.2 B+, and $80M fund management expertise to run troubled companies and recovery funds, advise company boards, litigators, institutional and private equity investors. John parachutes in as CEO, or senior executive to turn around a trouble entity, and serves as outside director. John is inductee into the Turnaround Management, Restructuring, and Distressed Investing Industry Hall of Fame. John is Past Chairman of Turnaround Management Association (TMA), Chairman of Association of Interim Executives (AIE), and Senior Fellow of the Turnaround Management Society. John is a Founder of TMA. John was honored: Interim Management Lifetime Achievement Award from the Association of Interim Executives, Prince Georges Business Leader of the Year, and Most Admired CEO in Maryland. John works with small business and middle market companies in job-shop, manufacturing, hightech, federal government contracting, 8a, defense, aerospace, electronics, engineering services, communications, information technology, software, computer, fabrication, construction, printing, marine, finance, and wholesale industries.

Writing Credits

Select writing credits include *Director's Monthly, Corporate Board, Directorship, Smart CEO Magazine, Mergers & Acquisitions, Venture Capital Guide, Journal of Private Equity, Shareholder Value Magazine, Valuation Issues Magazine, Thomson's Buyouts Magazine, Journal of Corporate Renewal, Strategic Finance Magazine, Financial Executive Magazine, Institutional Investor, Commercial Law Bulletin, New Jersey Lawyer, ABF Journal, Successful Restructurings, Dow Jones Bankruptcy Review, Printing Impressions Magazine, Print Profit Magazine, Military Engineer, BMDO Update, Manage Magazine, Contract Management Magazine, The Fabricator, Secured Lender, Lending and Risk Management News, RMA Journal, Commercial Loan Monitor, Journal of Working Capital Management, Journal of Business Strategy*, among others. In addition, we have been quoted or featured in the *Wall Street Journal, Washington Post, Baltimore Magazine, Baltimore Sun, Warfield's Business Record, The Daily Record, Washington and Baltimore Business Journals, Success Magazine, Bloomberg Magazine, Europe Magazine, Bankruptcy Court Decisions, International Treasurer, M & A Magazine, Turnaround & Workouts Magazine, ABF Journal*, and others.

About the Firm

Strategic Management Partners, Inc. has substantial experience advising corporations and individuals on the strategic and mechanical issues of corporate development and governance, distressed company operating management and turnarounds for asset recovery, value preservation, and investing in underperforming companies.

The firm has been advisor to Presidents Bush (41 and 43), Clinton, and Yeltsin, World Bank, EBRD, Company Boards, Lenders, and Equity Capital Investors on leadership, rebuilding troubled companies, investment recovery, turnaround management and equity investing. SMP is celebrating over 25 years of service to its clients. SMP was named Maryland Small Business of the Year, and received the Governor's Citation from Governor Martin O'Malley, the State of Maryland, as a special tribute to honor work in the areas of turning around troubled companies and saving jobs in Maryland. Turnarounds & Workouts Magazine twice named SMP among the Top Outstanding Turnaround Management Firms. American and Baltimore Business Journals named SMP among the Most Active Turnaround Management and Consulting Firms in Baltimore, Washington, and the Mid-Atlantic Region. SMP was honored with the Turnaround Atlas Award for Turnaround Consulting Firm of the Year (Boutique) by Global M&A Network.

We work with and support the equity capital community to provide assessment studies to determine the situation, planning and strategy development to direct the company, crisis management to oversee that assets are not squandered away, workout teams that recover assets, and board level oversight to keep the client headed in the right direction.

We seek strategic alliances with private equity and investment recovery funds.

www.StrategicMgtPartners.com

Reference

Strategic Management Partners, Inc.

Turnaround Management Firm
http://www.StrategicMgtPartners.com

SMP Library
http://www.StrategicMgtPartners.com/library/libindx.html
http://www.StrategistLibrary.com

SMP Celebrates 25 Years in Turnaround Business
http://www.StrategicMgtPartners.com/smp20yr.html

SMP Wins Turnaround Atlas Award for Turnaround Consulting Firm of the Year, *Global M&A Network*
http://www.StrategicMgtPartners.com/atlastcfy.html

SMP Named Among Top Outstanding Turnaround Management Firms by *Turnarounds & Workouts*
http://www.StrategicMgtPartners.com/twtop12.html

SMP Named Maryland's Small Business of the Year and Received the Governor's Citation
http://www.StrategicMgtPartners.com/mccsbyr.html

SMP Named to Most Active Turnaround Management Firms in Mid-Atlantic List by
American and Baltimore Business Journals
http://www.StrategicMgtPartners.com/press/bbj2012ta.html

Collard Summary Information
http://www.StrategicMgtPartners.com/jcsum-ta.pdf

Collard Enters Turnaround Management, Restructuring, and Distressed Investing Industry Hall of Fame
http://www.StrategicMgtPartners.com/thof.html

Collard Past Chairman, Turnaround Management Association (TMA)
http://www.StrategicMgtPartners.com/pastchair.html
http://www.turnaround.org/Membership/MemberDetail.aspx?memberID=450

Collard Interviewed by InterimCEO
http://www.interimexecs.org/leading-by-example
http://www.interimexecs.org/john-m-collard

Collard on NewsReleaseWire
http://www.expertclick.com/19-626

Social Media
http://www.linkedin.com/in/JohnMCollard
http://www.facebook.com/JohnMCollard
http://twitter.com/JohnMCollard

Reference (Continued)

Articles of Interest:

Managing Turnarounds Requires Clear Thinking, Quick Action, and a Plan, *RMA Journal*
http://www.StrategicMgtPartners.com/rmaphases.pdf

Managing Turnarounds in Times of Crisis, Phases and Actions, *Directorship*
http://www.StrategicMgtPartners.com/directorshipactions.pdf

Recover & Preserve Value: Working Successfully With Turnaround Professionals, *ABF Journal*
http://www.StrategicMgtPartners.com/abfjvalue.pdf

Deathbed Businesses: When a Business Stops Growing. It Starts Dying., *Smart CEO Magazine*
http://www.StrategicMgtPartners.com/smartceo.pdf

Is Your Company In Trouble? Early Warning Signs Pinpoint Business Troubles, *Corporate Board Magazine*
http://www.StrategicMgtPartners.com/tcb.pdf

Steering Clear of the Brink, *The Journal of Private Equity*
http://www.StrategicMgtPartners.com/jpe-ews.pdf

A Hands On Approach. *Mergers & Acquisitions*
http://www.StrategicMgtPartners.com/ma-inv.pdf

Looking For The Exit: Investing in Underperforming Companies, *Dow Jones Bankruptcy Review*
http://www.StrategicMgtPartners.com/djexit.pdf

Value Creation Model. Built to Sell, *Shareholder Value Magazine*
http://www.StrategicMgtPartners.com/svm-vcm.pdf

Director's Guide to Defense Conversion: How to Avoid Minefields in Marketplace, *Director's Monthly*
http://www.StrategicMgtPartners.com/dm.pdf

All Leaders Are Not Created Equal: To Save Company -- Change Leadership Style, *Director's Monthly*
http://www.StrategicMgtPartners.com/dml.pdf

Outside Directors Offer Valuable Guidance, Contacts, *Baltimore Business Journal*
http://www.StrategicMgtPartners.com/bbjod.pdf

6 Ways Outside Directors Benefit Business Growth. You Need These Guys, *President & CEO Magazine*
http://www.StrategicMgtPartners.com/pceodirectors.pdf

Quick Leadership & Benefits of Interim Managers. C-Level Execs Make a Difference, *ABF Journal*
http://www.StrategicMgtPartners.com/abfjinterim.pdf

Raising Money In Tough Times: Easier Than You May Think., *Turnaround Management Journal*
http://www.StrategicMgtPartners.com/tmjmoney.pdf

Mission Possible: Six Questions Your Mission Statement Should Answer, *BMDO Update*
http://www.StrategicMgtPartners.com/bmdo-m.pdf

Incentive-Based Compensation - If You Want Results, Show Them The Money! *Fabricator Magazine*
http://www.StrategicMgtPartners.com/fm-ibm.pdf

End …