Maximizing Corporate Performance:

Moving from Defense to Offense with Stakeholder Support

By Daniel F. Dooley

Mr. Dooley is a managing partner at Morris-Anderson & Associates' Chicago office.

The last couple of years have been tough for corporate executives, fighting global competition and the recession as they struggle to maximize performance. So how can they help ensure lenders and other stakeholders will cooperate as they implement plans to increase corporate performance, whether through growth or acquisition? By considering lender perspectives and learning from the tough times shared by all, past and present.

Sins of the Past

Industry roll-ups are not necessarily accretive to value: Simply putting together a group of similar businesses-in terms of market and industry-to form a bigger business doesn't create accretive value unless more cash is generated by the new business. We have witnessed too many roll-ups where no cost takeouts were planned, cross-selling between the businesses was unrealistic, and roll-up management was only capable of adding overhead-and not up to the task of managing the much larger and diverse business resulting. Typically, these roll-ups have failed, with many of them "unrolled" and the original sellers buying them back at a fraction of the sell price.

Weak or non-existent operating due diligence: It is amazing how little due diligence investors and lenders were performing in the late '90s. They've learned, however, that just because the numbers add up on an Excel spreadsheet doesn't mean that a business plan can be executed.

Increasing valuation and multiples are unsustainable because business is cyclical: EBITDA valuations of 7 to 8 or more in mature industries, accompanied by senior debt leverage of 3.5 to 4 times, were common in the late '90s. Investor and credit returns are only possible at these prices if the specific industry involved has perpetual growth prospects, which is highly unlikely.

Valuations based on top-line measures: During the go-go 90s, too many were using sales, website hits, customers, market share and other non-monetary factors to value businesses, ignoring the obvious fact that businesses only have economic value if they generate cash. As we are all painfully aware now, many Internet businesses never even developed a spreadsheet plan showing positive cash flow, opting instead to get bigger and bigger by consuming OPM (Other People's Money).

Great times make for great crooks: The extent of corporate greed and corruption seems to be directly related to how a business is doing financially. In great times, stakeholders are ecstatic and outside oversight is greatly relaxed, leaving some leaders to believe they single-handedly created the value and "to the victor go the spoils." It goes without saying, then, that in leaner economic times, there is much more oversight.

Lessons to Remember

Employ operators, not accountants, for due diligence: For an underperforming company, lenders keep tabs on inventory, receivables and financials, but the critical due diligence questions remain, 1) is the business plan attainable, 2) is management on top of its business issues and taking action, and 3) are there critical business issues that management hasn't identified or allocated resources to attack? These are areas where workout consultants succeed because we have witnessed-and cleaned up-many similar messes. Make sure the best team is in place.

M&A integration is mission-critical: In acquisition mode? Have a plan detailing how the acquisition should be run and integrated into the existing business. Bear in mind, however, that existing management is rarely good at integration: much like an IT project, the process takes twice as much money as planned, twice as long and only delivers half the planned benefit. If your company is looking at acquisition integration, we recommend focused, full-time consultants who specialize in the process.

Be careful of long-term sales growth plans: This is NOT to say

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that substantial sales growth can't happen. Rather, one must analyze-through operational due diligence-the specifics of the sales growth planned and the competitive landscape that could adversely affect the plan.

Morality cannot be legislated, so make sure you and your team have guts: Sarbanes-Oxley is a classic attempt to regulate morality and, despite being well intended, it simply won't work. That being said, the most forward-thinking corporate leaders and their lenders bet on two critical personnel when backing a company: offensively, bet on the CEO to achieve the business plan. Defensively, bet on the CFO to be brutally honest and raise the red flag when needed. I have always thought that a CFO should be hired more for personal character and guts more than technical skills, and have found that the best acquirors of businesses put in their own trusted CFO or make very sure they're willing to take a risk on a new one.

Morris-Anderson & Associates (www.morris-anderson.com) helps companies maximize their enterprise value by providing strategic, financial and operational consulting to financially distressed and underperforming businesses from its offices in Atlanta, Chicago, Dallas, Houston, New York, Milwaukee, Tampa and Washington DC.

TOP 10 WARNING SIGNS OF UNDERPERFORMANCE

1. Monthly financial targets are not known to all key managers. Everybody accomplishes more with clear and visible goals. Ask the plant or sales managers what their critical goals are for the current month. Any answer other than a specific numeric target is a Red Flag. Successful businesses "drive everyone" toward key statistical goals-orders, shipments, collections, etc. If key managers don't know the goal and don't commit to its attainment, everyone is just "doing the best they can." **2. Management doesn't know its current breakeven point.** This is especially critical for a company that is losing money or in a downward slide. Typically, management says "the breakeven depends on the mix." That's a strong signal that management doesn't understand how to address its critical problems. Management must have a good idea of its "cash breakeven" (as opposed to "P&L breakeven") when the business is in the zone of financial distress. If not, they will always be behind the curve when it comes to resizing the cost structure. This is why many firms go through multiple rounds of layoffs. **3. Management has no written action plans.** The act of writing action plans and then communicating them to managers and other stakeholders, such as lenders, is an act of commitment. Many managers of distressed companies are so caught-up in the crisis that they spend inadequate time analyzing and fixing their underlying problems. By the way, a useful plan is not an elaborate PERT chart, but rather a simple list of key issues and the who/what/where/when/how of fixing them. **4. Senior management is not into the details of the business.** Companies need at least one senior manager monitoring the pulse of the business on a daily basis. Presidents, owners, CFO's, and VPs of operations or even sales can fulfill this role with great results. This is about assuming command and accountability for the business-if all the senior managers are "stay in the office" types who are proud of their delegation skills, beware. **5. Fiscal metrics are tracked only monthly.** The bigger the financial crisis, the more frequently leaders must have measures to stay in control. Even for a successful company, monthly measurement is just not often enough. A distressed company needs to identify five to 10 key measurements, and then track, trend and communicate them weekly. **6. The organizational chart is non-existent or very outdated.** The failure to formally define managerial responsibility and accountability can lead to disaster. Either there are lots of overlaps and conflict, or voids leaving critical tasks addressed. For example, when one of our clients brought us in to act as interim COO, we found that two key engineers hadn't had a boss for years! **7. Operations department has minimal non-financial metrics.** Because "operational performance drives financial results," the failure to track key success factors is a big warning sign. Management needs to measure same-store sales, on-time shipments, new orders, product returns, etc. Good functional managers don't depend on the Controller to do this, they do it themselves. **8. Management can't list a single meaningful accomplishment from the last 90 days.** If senior managers say they worked hard the last 90 days, but have done nothing other than keep the business alive, something's wrong. Effective managers accomplish tasks that are important to improving or at least maintaining the company's financial performance. If the last 90 days were lackluster, will the next 90 days be any better without intervention? **9. Management has no meaningful financial incentive to improve the company's performance.** Oftentimes, senior managers have no financial incentives, period; have financial incentives that are very small relative to their base pay (under 20%); or have incentives that are meaningless as incentive triggers, or are unattainable because the company's financial performance has been so poor. Our experience shows that senior management must be in a position where they can financially benefit from the successful implementation of a plan. Then, if the management team isn't excited about the risk/reward challenge, it's obvious the wrong players are on the team. **10. Quality is critical to the business, but facilities housekeeping is poor.** As a general rule, a company can't manufacture, distribute or sell quality products or services in a messy physical environment.

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