How to Profitably Grow Underperforming Companies

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A highly-leveraged middle-market company lacking both a unique Value Proposition and a team-oriented culture, regularly leads to EBITDA losses and a cash burn. Doctored financial results can hide the serious financial condition from stakeholders—allowing the deterioration to continue for up to one to two years.

To profitably grow underperforming companies:

1. Develop and Implement a Unique Value Proposition and Detailed Strategy.
2. Establish/Renew a Team-Oriented and Customer-Focused Culture.
3. Determine That the Results are Not Doctored.
4. Don't Slow Walk the Changes.

01. Develop and Implement a Unique Value Proposition and Detailed Strategy

Endless financial models with detailed assumptions, SWOT's and budget Power Point presentations are too frequently mistaken as a strategy process by middle-market companies. Strategy focuses on creating value—different from your competitors—with a unique Value Proposition. Implementing a strategy will result in a more predictable, profitable revenue stream that can compensate for the risk of high financial leverage.

Too often, instead of focusing on developing a unique Value Proposition and the detailed strategy, senior management emphasizes an ongoing headcount fine tuning. This will soon damage the organization's trust and unique capabilities, which are the foundation for your unique capabilities and Value Proposition.

The word "strategy" is over-used and managers refer to most things as being "strategic."

Strategy is not:

- Goals and objectives. They are outcomes and do not detail the actions required.
- Financial models with detailed assumptions.
- Better management of the sales force.
- Copying what a competitor does successfully.
- Trying to leverage the so-called Strengths—from the SWOT exercise—that competitors can do as well. Non-strengths can't be differentiated.

Strategy is:

- Identifying and then leveraging your unique capabilities (skills, services, technology and processes).
- Offering a unique Value Proposition—that competitors can't copy—supported by your unique capabilities.
- Identifying market segments and targeted customers that need and will pay a premium for your unique Value Proposition.
- Offering those targeted markets and customers a unique Value Proposition that meets their important needs so you don't just compete on price.
- Identifying what to avoid—customers, product lines, geography, etc.
- Establishing boundaries in the decision-making process regarding which opportunities will be pursued and which will not.
- Developing strategic priorities to execute the strategies.
- Continuing to strengthen the specific unique capabilities that support your unique value proposition.

Continually scanning the environment—industry, markets, customers, competitors, regulations, trends—to identify changes in the rapidly-changing world market is part of Strategy's continuous process.

Strategy Requires Difficult Choices

Developing a unique strategy forces the CEO to make difficult choices, and this will create conflict within the organization because you can't do everything everyone wants. Many times the CEO either asks for endless incremental analysis—to delay making a decision—or spreads the limited resources to the legacy business units with the loudest voices. Regularly challenging which legacy assets to redeploy must be part of the strategy process, and such process should not just be an annual exercise. The worldwide markets won't wait on your annual planning process. Strategy setting—decisions and actions—must be a continuous process throughout the year.

Strategy Development Suggestions:

- It's critical that you begin the strategic process with an independent market and intelligence base. Externally-developed data will provide solid ground for the brainstorming sessions. Never blindly accept internal company and industry truisms—as they very often do not reflect market realities. In developing market intelligence, involve the business units, customers and suppliers and seek out current data as well as future market and competitive trends. The entire organization—both salaried and hourly team members—is responsible for providing market intelligence.
- Write down your current Value Proposition, usually 4-5 specific points. It should define:

  →What unique value you're delivering.

  →What specific customer groups you're going to serve.

  →What critical needs of the targeted customers you're going to satisfy.

→What you won't do. What you will avoid.

→What is the relative price.

- Is your Value Proposition really unique?
- What are your unique capabilities that drive your Value Proposition?
- Map your entire supply chain—working backwards from the end user.
- Determine your targeted customers' most important needs; talk with them.
- Ask again: What unique skills, services, technology or processes are you providing?
- What could you add or change that would make your Value Proposition and supply chain unique to a specific market segment and specific customers?
- Ensure that every team member in the organization can state your unique value proposition. If they can't, then you don't have a strategy.
- Everyone in the organization must know upon what unique capabilities your value proposition is based.

Test Your Strategy

Before a strategy is finalized, you must answer "yes" to the following three questions, or redo the strategy:

- Within the implementation period, do you have the resources—cash/debt capacity, staff, systems, skills—to successfully implement the strategy?

- Does the projected ROIC exceed your cost of capital? Exceeding your cost of capital, however, should be a bare minimum. Instead, strive to be in the top quartile for your industry.
- For poorly-performing and distressed companies, the strategy must free up significant cash and reposition significant assets and business units as well as grow profitable revenues.

As I mentioned in my Marketing News article **Create, Revise Channels for Customers**: “To minimize price competition, senior management must continually redefine how it creates value for customers and the end-user. After that, adding value requires close collaboration among all organizational functions and employees.” A team-oriented and customer-focused culture breeds innovation and is the foundation for developing and implementing a strategy.

02. Establish / Renew a Team-Oriented and Customer-Focused Culture

Poorly-performing and distressed companies almost uniformly possess a weak organizational culture. In such companies, the CEO and senior management team generally do not spend the majority of their time at the business units and with customers and suppliers. Instead, they frequently create a culture of headquarters-issued directives that may be out of step with the on-the-ground realities of the business units tasked with their implementation. Culture can be a sustainable competitive advantage and the foundation for the strategy because culture can’t be copied; every company has a distinct culture. For instance, Zappo’s is different than Apple’s, and both companies are successful. Unfortunately, because it does not show up on a spreadsheet, decision makers and stakeholders frequently overlook both culture’s importance in explaining current financial conditions as well as the opportunity it presents to improve them.

Most stakeholders don’t believe organizational culture drives cash flow, but it does. I’ve always heard that Peter Drucker commented that: “Culture eats strategy for breakfast.” Because your strategy is executed every day by everyone in the organization, your culture—what guides how everyone in the organization acts—determines whether or how well that strategy is executed. If your culture is based on trust, enthusiasm, accountability and is team-oriented, then it’s is likely your strategy will be implemented. Culture can be the key driver in achieving a superior ROIC by the way employees work together to execute day-to-day activities as well as how they work together in identifying growth opportunities.

Following are **two examples** from my Interim CEO engagements:

- At a union plant in West Virginia: I went to the plant floor and talked to most of the union craftspeople over two days. On the second day, a union craftsperson said: “You’re the first CEO who ever listened to us.” I asked how he knew I was listening. He said, “Because you’re writing down everything I’m saying, and you already made changes from what the guys told you yesterday.” On the next day, the craftspeople gave me a lot more recommendations because they saw that some of their recommendations were already being implemented. We named that plant as one of the “transportation centers of excellence,” which became a great opportunity for the plant and the craftspeople.

- At the HQ’s of a nationwide company: I asked the CEO how much time he spent at the over thirty branches and with their local customers and suppliers. He said not much lately, but when he looked at his calendar, it got worse. For the last six months, the CEO

  had only spent a few days at the branches. I told him the best source of market intelligence and instilling a strong culture was by spending most of his time at the business units and with the local customers and suppliers. However, the CEO justified spending almost all of his time at the HQ’s by saying that he regularly communicates with the branches from HQ’s and believed that that was sufficient. After a review, we determined that most of his time was spent developing Power Point presentations for the monthly board meeting. Over $20 million in working capital write-offs later, the CEO exited the company. The board also discovered a badly-bid backlog—**poor market intelligence**—with losses or low margins on more than half of the $100 million backlog.

What are the key points in renewing and changing an organizational culture?

- CEO is the prime driver through his/her actions, such as: who is promoted, who is assigned to special projects and who continues to get more responsibility.
- CEO must spend the majority of the time at the business units and with customers and suppliers.
- The required work can't be done from the HQ's alone or just through the human resources group.

03. Determine That the Results Are Not Doctored

Why did the real financial results turn out much worse than the shareholders were told? Why suddenly do we have a cash crisis? If the company is middle-market, highly leveraged, and poorly performing, there is an excellent chance that the results have been doctored. Consistently doctoring the financial results hides the serious financial condition from the shareholders and debt holders (collectively defined as stakeholders).

If senior management doctors the results, the stakeholders could be misled for one to two years—during which time the company's position continues to deteriorate towards non-viability. While senior management believes that they are just buying time until an expected improvement is realized, the reality is that their doctoring becomes more aggressive because of their monthly failure to meet the cash and P&L forecasts. Not surprisingly, this results in an ever-increasing discrepancy between the company's actual position and the stakeholders' knowledge of it. Board members develop close relationships with the CEO and are hesitant to believe one would mislead them—especially since the CEO is an equity owner.

The board must remain independent—both perceived and actual—from senior management. We regularly hear from organizations that it's no use speaking up because the CEO is really tight with the board and we'll be fired.

The board must regularly determine the real trended EBITDA and cash flow. You don't need forensic accountants to understand whether senior management doctored the monthly financial results and forecasts. A good starting point to flush out such shenanigans is to regularly examine specific **trended** data—on a spreadsheet, detail **every** individual reserve account for the trailing 24-months and make sure the sum of each month's reserves ties to the general ledger as of the same date.

04. Don't Slow Walk the Changes

Don't accept the thinking that the organization can't digest significant changes so quickly. If a slow or cautious approach to organizational adjustment was effective, the company would not be underperforming. The board must ensure that strategic changes are implemented immediately, since it will establish an essential sense of urgency within the company as well as stop the cash burn. Too often stakeholders believe that the organization and customer base would be scared off or overwhelmed by making significant changes. The truth is that both the organization and the customers would applaud such action.

Example of Bold Action:

> I was named Interim CEO of a nationwide company after the Board discovered $29 million of surprise P&L write-offs. The company had a $750,000 weekly cash burn, debt defaults and a low margin backlog. We immediately sold the cornerstone business unit—a low margin, asset and working capital intensive with high risk projects—along with a smaller business unit and reinvested the proceeds in a capital-starved business unit with good margins and potential. We implemented a strategy that revamped the value and supply chains as well as the bidding methodology and provided what the targeted customers wanted most: more competitive prices coupled with improved construction cycle times. We then implemented some of the key capabilities at other business units and also continued to improve these capabilities. We provided the targeted customers with value that no competitor could match, and our margins surged. The new strategy increased the EBITDA percentage from a negative 13% to 26% and within three years, we increased the enterprise value by $176 million. Given the serious situation, bold measures had to be taken.

CEO’s are the driving force behind developing and implementing successful strategies—as well as establishing an innovative culture. Given the CEO’s importance in maximizing shareholder value.

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