# Is Your Company In Trouble? 10 Early Warning Signs Pinpoint Business Troubles.

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Is Your Company In Trouble? 10 Early Warning Signs Pinpoint Business Troubles.

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.

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 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."

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, and 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 the 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 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 the 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.

About the Author
John M. Collard, is Chairman of Annapolis, Maryland-based Strategic Management Partners, Inc. (410-263-9100, www.StrategicMgtPartners.com ), a nationally recognized turnaround management firm specializing in interim executive leadership, asset recovery, 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, $85M asset recovery, 40+ transactions worth $780M+, and $80M fund management expertise to run troubled companies, and advise company boards, litigators, institutional and private equity investors.

John M. Collard (Strategist@aol.com)
Chairman
Strategic Management Partners, Inc.

522 Horn Point Drive
Annapolis, MD 21403
Phone : 410-263-9100
Fax : 410-263-6094

www.StrategicMgtPartners.com

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